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GOVERNMENT - PRIME CONTRACTOR SUBCONTRACTOR RELATIONSHIPS: ON ANALYSIS

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GOVERNMENT - PRIME CONTRACTOR -
SUBCONTRACTOR RELATIONSHIPS:
AN ANALYSIS

by

Kenneth George Dewell

December 1979

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This study was undertaken to delineate, analyze, and evaluate the various relationships established between the Government, prime contractors and subcontractors in the acquisition of modern weapon systems within the Department of Defense. Envisioned were the achievement of two primary objectives. First, to identify the relationships as currently established, as well as any significant problems created by these relationships and second, to attempt to

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Research methodology consisted of an extensive literature view along with personal interviews of key acquisition ficials within both Government and industry.

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Government - Prime Contractor - Subcontractor Relationships: An Analysis

by

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Lieutenant, Supply Corps, United States Navy
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requirements for the degree of

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from the

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December 1979

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I. INTRODUCTION

A. OBJECTIVES OF THE RESEARCH

The basic purpose of this study is to delineate, evaluate and analyze the various relationships which have evolved between the Government and its prime contractors and subcontractors to implement and carry out the objectives of the Federal acquisition process. Envisioned herein is the achievement of two primary objectives: first, to identify the various relationships which exist between Government, prime contractors, and subcontractors, along with any inherent problems caused by these relations, and second, to analyze the impact of these relationships on the Federal acquisition process through evaluation of key problems as perceived by the parties involved.

It is hoped that a more thorough understanding of current Government-prime contractor-subcontractor relationships will benefit a variety of key acquisition personnel both within industry and Government. Program managers, contracting officers, contract administration officials, and industry acquisition officials must constantly interact with and make decisions impacting on one another. A more thorough understanding of relationships may facilitate and enhance this decision making process, hopefully, resulting in more equitable policies, better procurement practices, and improved relations between all participants. In addition, it is envisioned a more

thorough understanding of Government-prime-subcontractor relationships will assist Government and industry acquisition officials in working more effectively within the established acquisition framework, reduce the general adversarial nature of contracting currently perceived, and further the efforts of all parties in achieving their stated goals and objectives. Finally, identification and analysis of key problems with existing relationships may ultimately lead to changes or alterations in current relations, or possibly new relationships, resulting in more effective and efficient procurement practices.

B. RESEARCH QUESTION

Given the preceding general objectives, the following primary research question is posed: What is the impact of the relationships which have evolved between the Government, prime contractor, and subcontractors on the Federal acquisition process?

The following secondary research questions are deemed pertinent in addressing the basic research question:

What are the current relationships?

Are these relationships efficient and effective?

What changes or modifications to these relationships are feasible or desirable in an effort to enhance the acquisition process?

C. SCOPE, LIMITATIONS, AND ASSUMPTIONS

The scope of this research effort is primarily concerned with Department of Defense (DOD) weapon system acquisitions and, with regard to subcontracting, those subcontractors providing major critical components utilized within these systems. This effectively means first tier subcontractors.

This study is limited by the fact that the author is not a lawyer and, while some legal questions arise with regard to relationships discussed, any suggested changes or alterations in existing relationships are proposed only from the standpoint of attempting to enhance the acquisition process. Legal questions and ramifications arising from suggested changes are not addressed. Furthermore, research efforts were limited somewhat by a lack of current literature regarding the subject in question thus personal interviews and telephone conversations were relied upon heavily. Unfortunately, due to time and fiscal resource constraints, the sample size of interviewees is recognized as being inadequate to draw statistically convincing conclusions. However, it is felt that data gathered from interviewees, when utilized in conjunction with the existing literature base, are sufficient for the identification of trends, and potential problem areas, within the current Government-prime contractor-subcontractor relationship framework.

Finally, it is assumed the reader is knowledgeable to some degree regarding DOD contract language, methods of

contracting and types of fixed and flexible contract instruments. In addition, it is further assumed the reader is familiar with the program manager concept utilized in acquiring complex highly technical pieces of hardware.

D. RESEARCH METHODOLOGY

The research methodology utilized in this study consists of two basic components: (1) development of a comprehensive literature base, and (2) the use of personal and telephonic interviews designed to augment and update literature information as well as provide personal experiences and opinions with respect to the research area. The literature base was compiled primarily through the Defense Logistics Studies Information Exchange (DLSIE), the Federal Acquisition Institute (FAI) Library, the Naval Postgraduate School Library, Federal Publications, Inc., and a review of various journals and periodicals which concern themselves with Government acquisition. Personal and telephonic interviews were conducted with DOD policy makers, Program Managers, Procuring Contracting Officers (PCO's), Administrative Contracting Officers (ACO's), contract administration personnel and industry executives involved in Government procurement at both the prime contractor and subcontractor level. Interviews were structured around the prepared questions contained in Appendix A.

E. LITERATURE REVIEW

During the course of compiling the literature base for this study, it was noted with some concern that most of the literature outlining Goverment - prime contractor - subcontractor relationships, and the associated problems and complications allegedly caused by these relationships, was somewhat dated. However, based on personal and telephonic interviews, it appears the picture as portrayed in the literature base remains fairly accurate. This lends credence and a sense of currency to those thoughts and ideas expressed in the literature even though somewhat dated.

F. DEFINITION OF A SUBCONTRACTOR

One of the first problems encountered in this research effort was that Government procurement regulations do not provide a definition for a subcontractor. Therefore, for the purpose of this effort, a subcontractor will be defined as: any person including a corporation, partnership, or business associate of any kind who holds any contract or agreement to perform any work, or to make or furnish any materials required for the performance of any one or more prime contracts or subcontracts.

G. ORGANIZATION OF THE STUDY

This study attempts to take the reader throught the subject at hand in the most logical manner possible.

Chapter II is designed to inform the reader as to the acquisition framework within which Government - prime contractor - subcontractor relationships function. Included are discussions as to the peculiar aspects of the Federal acquisition process itself, and how this process affects both prime and subcontractors, the unique economic and legal position of the Government as a buyer, and the need for special Government policies and procedures when acquiring complex weapon systems. In addition, basic relationships between prime contractors and subcontractors and between the Government and subcontractors will be introduced. Furthermore, the concept of "privity of contract" will be discussed, which will later play a key role in the discussion of problems caused by current relationships. In Chapter III a chronological background study will concern itself with significant changes in the Federal acquisition environment. These changes not only enhanced the Government - prime contractor - subcontractor relationships, but have also contributed to a more problematic environment concerning these relations. Chapter IV will then delineate the relationships as they exist today, while Chapter V will delve into major problems with present relations as viewed or perceived by the parties involved. Chapter VI will offer conclusions and recommendations, along with an assessment of any areas requiring further study and investigation.

II. FRAMEWORK

A. PREFACE

Prior to any meaningful discussion involving current Government - prime contractor - subcontractor relationships, pertinent key information and concepts must be presented. First, an understanding and appreciation as to the peculiar aspects of the weapons system acquisition environment must be outlined. Second, an explanation as to the Government's unique position as a sovereign and as a monopsony, with regard to the defense industry, will provide valuable insight into how the Government effectively shapes, molds, and influences relations between itself and its industry counterparts. Third, a broad conceptual picture of the types of relationships currently established between Government and industry will be provided as well as an introduction to the concept of "privity of contract" which will later play a key role in analyzing the relationships.

B. DEFENSE ACQUISITION ENVIRONMENT

The situation and circumstances surrounding the acquisition of complex weaponry are often quite different from those experienced when attempting to procure standard commercial products sold to the general public in a competitively free market environment. In many cases, defense acquisitions require industry to design, develop,

and produce complex systems which are totally new and unique; often requiring advances in the state-of-the-art to effectively deliver the end item. Such acquisitions are characterized by a great deal of uncertainty involving technical, engineering, production, and scheduling aspects. Cost also looms as a large uncertainty, for even if fairly accurate cost estimates are derived prior to the time of award they are liable to change drastically as previous unknowns become realities. Furthermore, while competition may be prevalent in the earlier conceptual design and development phases of the acquisition cycle it is difficult and expensive to maintain competition throughout the entire process. Usually, the company whose design and development concepts were selected for full-scale engineering development and production will possess obvious advantages over the firm brought in later to duplicate the original contractor's efforts. At times, the original producer may succeed in retaining data rights and technical information making it that much more difficult for other sources to interject competition and its many resultant benefits. While second sourcing has and continues to be attempted in large weapons procurement, it appears that it is still the exception rather than the rule.

Given this scenario, filled with risk and uncertainty for both Government and contractor alike, and often void of true competition, it is obvious the Government cannot

provide industry a proposal for a major acquisition, along with millions and perhaps billions of dollars, and then simply sit back and wait for the finished product to be delivered. On the contrary, the Government insists on achieving the visibility, control, and managerial information necessary to protect its interests and help ensure, to the maximum extent possible, that the system provided will perform as envisioned, will be delivered on time, and will cost that which was initially envisioned at the time of award.

Adding to this already complex scenario is the concept of public trust and the requirement for the judicious expenditure of taxpayer dollars. If industry plans, manages and executes a major commercial acquisition poorly, resulting in large corporate losses, not only may key personnel lose their jobs, but the company as well may cease to exist. In Government, while large cost growth or ineffective spending of funds may cost people their jobs, it is unlikely the Government will cease to exist as monies assigned to other projects will be reappropriated to cover lost funds. Without the fear of bankruptcy present in industry, there may be less incentive within Government to allocate scarce fiscal resources wisely. This results in the need for additional monitoring and controls, along with enhanced Congressional and taxpayer surveillance over major spending programs, to ensure not only that the

Government receives the products needed but also that the taxpayer receives the best possible product for his money.

The end result of these aspects of the defense acquisition environment has been the evolution of a complex acquisition process built upon a multitude of Federal statutes, regulations, executive orders, procurring agency directives, and judicial and administrative rulings and decisions designed to protect and to further Government acquisition interests and policies, safeguard the judicious expenditure of public funds, and help ensure the Federal Government receives the best possible products for its money.

In addition to the statutory and regulatory elements designed to maintain visibility and control over weapon system contractors, various organizations have also been created to assist in this process. Three of the more important of these are the Program Manager (PM) organization, the Contract Administration Office (CAO), and the Defense Contract Audit Agency (DCAA). Under the PM concept, one individual, assisted by staff members in a variety of fields such as engineering, contracting, logistics, production, and finance, is given overall responsibility for the successful design, development, production, and deployment of a major weapons acquisition item. The PM must constantly interact, manage, direct, and control the contractor to ensure successful completion

of his project. The CAO is designed to assist the PM, or on lesser projects the procuring agency, by functioning in the field as the Government's "eyes and ears". While the various functions assigned to CAO organizations are outlined in Defense Acquisition Regulations (DAR) 1-406, some of these functions include conducting of pre-award surveys, designed to ascertain whether a contractor possesses the necessary technical, personnel, and financial capabilities deemed essential to satisfactory performance; monitoring production progress; surveillance of schedules; performaing quality assurance functions; and alerting the PM, or buying activity, of potential problems which may affect successful program completion. The primary function of DCAA is to evaluate the legitimacy of proposed costs submitted by prospective contractors, along with conducting audits designed to identify any unallowable or defective costs submitted to the Government, to ensure the buyer is being charged fairly and equitably and that he pays only that which is rightfully owed for products received.

Having previously demonstrated the need for Government control, visibility and information regarding the procurement of complex highly technical weapon systems, it can now be seen that an organizational, statutory, and regulatory framework exists which is designed to achieve this end. Through every phase of the procurement cycle from planning to solicitation, source selection, negotiation, award, and

contract administration this complex mechanism of people, policies, and procedures strives to maintain that degree of visibility, control, and influence necessary to protect and foster Government interests and objectives.

While admittedly, the defense acquisition framework is designed primarily to protect and foster the interests of the buyer, contractor interests and objectives are also recognized. The framework previously described strives to equitably share risks with contractors through the use of differing contract types depending on an assessment of risk incurred by each party concerned. Progress payments, guaranteed loans, and in certain instances, advance payments are often available to contractors in an attempt by the Government to ease cashflow and financial hardships necessitated by the large capital outlays and long lead-times often required in weapons production projects. Procedures for the administrative settlement of differences between contracting parties are also included which attempt to provide equitable remedies for those who must deal with peculiar Government requirements such as the Changes Clause [10; Sect. 7], Inspection Clause [10; Sect. 7] and Termination Clause [10; Sect. 7]. Finally, Government owned equipment, machinery and materials are often provided contractors to offset at least part of the extensive capital investments required in certain weapons acquisition programs. While the preceding examples are by no means all

inclusive, the point is that the defense procurement system strives to create a two way street between buyer and seller. Recognizing that both parties need each other, the system, primarily through statutes and regulations, attempts to ensure that each party's goals and objectives are achieved simultaneously; not at the expense of one another.

C. THE GOVERNMENT AS A SOVEREIGN AND A MONOPSONY

The ability of the Government to establish the organizational, statutory and regulatory framework which serves to protect its interests and foster its policies, regarding Federal acquisition, has been enhanced immensely by the fact that the Government is a sovereign. Webster's dictionary defines sovereign as "one having supreme power." For our purposes, the Government as a sovereign allows it the tremendous advantage of making various rules and regulations it deems necessary to protect its interests prior to engaging in the activity to which the rules and regulations apply. When the Government, therefore, decides new rules and regulations will enhance its visibility or control over contractors, or when the Government feels the lack of specific rules and regulations are deleterious to Government interests and policies, new rules can be created to fill the gap. Public Law 87-653, known as the "Truth in Negotiations" Act is a prime example. In the early 1960's, the Government felt industry

was taking unfair advantage of non-competitive procurement situations and was citing faulty and erroneous cost and pricing data used to negotiate contract costs. The passage of this Act resulted in the requirement for contractors, in certain situations, to submit and certify that cost and pricing data were accurate, current, and complete. Failure to comply with the provisions of PL 87-653 may result in a contractor being declared non-responsive to the solicitation and subsequently cause the loss of award. Submission of other than accurate, current and complete data may result in price adjustments, including profit on defective cost elements, flowing from the contractor back to the Government. The concept of the Government as a sovereign also comes into play when discussing legal suits against the Government for breach of contract or failing to adhere to contract terms and conditions. This aspect will be discussed in much greater detail in Chapter V.

While the Government has the power to make the rules and regulations it later plays by, an argument might be offered that if contractors are unhappy with the present arrangement, or dislike the multitude of rules and regulations, they may choose to no longer do business with the Government. While this may be a true statement, once again the Government appears to have the upper hand and is indeed able to apply its rules and regulations to industry through its unique economic position as a monopsony, along with the

apparent inability of major prime contractors to easily exit the defense environment and diversify to commercial ventures. This places the Government in a rather strong bargaining position through which to interject those organizational and legal requirements it deems necessary to protect its interests. The seller, needing Government business to remain a viable entity, has little choice but to comply with Government policy and procedures. Often during interviews with key industry acquisition officials, it was related that when the Government is the only game in town, you play by their rules or not at all. While defense contractors have attempted to reduce their dependency on defense procurement dollars in the past, these actions appear to have met with only limited success, with the possible exception of the development of transport aircraft for commercial airlines. Professor Murray Weidenbaum of Washington University offers the following reasons for this situation: [49]

> ...concentration of management interests on defense and space business, limited marketing and distribution capability, lack of mass production experience, low capitalization in relation to sales, lack of experience in designing, producing and servicing consumer and industrial products and very specialized equipment.

While the Government does not hold all the cards with respect to defense contractors, since the Government needs industry to design, build and deliver the end item(s), it has certainly been effective in implementing those policies,

practices, and procedures deemed vital in controlling the acquisition process. Such actions have evolved through either its legal position as a sovereign, its economic position as a monopsony, or due to the nature of the defense industry itself with its numerous obstacles which discourage contractors from exiting to the commercial world.

D. GOVERNMENT RELATIONSHIPS

Having hopefully demonstrated the need for Government visibility and control over contractors engaged in major weapon acquisitions and having further alluded to the organizational, statutory, and regulatory instruments available to accomplish this end, it now becomes necessary to explore the means by which these instruments are applied to defense contractors through various relationships.

Government - industry relationships in the weapon system arena may be envisioned as follows. The Government establishes direct relationships with prime contractors, who in turn establish direct relationships with any necessary or desired subcontractors. In addition, the Government further establishes an indirect, vague and often nebulous relationship with subcontractors basically via the direct relationships which exist between the Government and prime contractors as well as between prime contractors and subcontractors.

With regard to prime contractors - those firms charged with the overall responsibility for system design, development and production, as well as the successful integration of all major system components - established relationships with the Government are direct and implemented primarily through statutory, legal and regulatory processes.

Statutory relationships are established between Government and industry by the creation of laws passed by Congress and approved by the President which dictate duties and responsibilities to both parties regarding acquisition practices and procedures. The Davis - Bacon Act, the Walsh - Healy Act, and Truth in Negotiations Act are all examples where requirements and responsibilities are placed on industry during the performance of Government contracting because these are laws of the land.

Legal relationships are established with industry via the contractual process. Regulations which outline procedures and processes designated to protect and foster Government interests, as well as outlining Government responsibilities, are stated in contract clauses. These clauses, in turn are compiled into one document which, when agreed to by both parties involved, constitutes a legally binding contract. Failure to abide by the provisions of a contract by either party, may result in a variety of administrative or judicial remedies designed to compensate or alleviate the injured party from damages caused by the

other's failure to live up to its contractual responsibilities. The delineation of each party's rights and responsibilities through a contractual instrument is called "privity of contract," The Government, therefore, establishes "privity of contract" with any firm with which it enters into a contractual relationship. The Government's right to inspect a contractor's quality control systems, the right to terminate contracts unilaterally, if deemed necessary, and the right to make certain unilateral changes with respect to contract performance are all examples of requirements which become binding on contractors through the establishment of a legal, contractual relationship.

Finally, a regulatory relationship is established between Government and industry when industry submits to certain Government regulations and requirements not because they are legally bound to do so but, from a practical standpoint, must abide if they want to be considered as viable contenders for contract award. In this scenario, the Government's position as a monopsony, coupled with industry's apparent inability to diversify to commercial ventures, are the driving forces for industry compliance as opposed to legal remedies for noncompliance prevalent in previously discussed relationships. The Government's right to perform preaward surveys along with the Government's ability to inspect and certify a prime contractor's procurement system are two examples of activities not

contained within any legal instrument but which are designed to foster and protect Government interests and applied to industry via regulatory relationships.

While those relationships established between the Government and prime contractors obviously constitute the cornerstone of successful acquisition ventures, they are direct and relatively uncomplicated. An even more interesting and complicated set of relationships occur when prime contractors involved in Government projects decide to subcontract major system components to other firms who supply these items to the prime contractor for integration into the total system.

As will be discussed at some length in Chapter III, the role of major subcontractors has continually increased as required Government systems become more technologically complex and tax the resources available within the prime contractor's facility. Today, many key subcontractors design, develop, and manufacture a variety of critical components vital to total system performance and may impact on ultimate program success as much if not more than the prime contractor. As an example, in the Apollo space program, approximately 20,000 contractors were involved; only a few of which were prime contractors [42; p. 63]. In addition, various documents and interviewees calculate the degree of public funds received by subcontractors at anywhere from 40% to 70% of the total funds allotted to a major acquisition. It appears the protection of Government

interests, the need for visibility and control of subcontracting initiatives, and the requirement for the judicious expenditure of public funds are just as important and necessary at the subcontractor level as at the prime contractor level.

The Government has chosen to achieve the required visibility and control over subcontractor efforts primarily through reliance on the prime contractor. One high ranking DOD official stated that it is the policy of DOD to pay for and therefore to hold the prime contractor responsible for the selection and administration of those subcontractors deemed necessary for successful program performance. Conceptually, this approach makes a great deal of sense. The Government establishes a direct contractual relationship with prime contractors, who in turn establish direct contractual relationships with required subcontractors. "Privity of contract" is established between the Government and prime contractors, as well as between prime contractors and subcontractors. However, as the Government purposely avoids "privity" with subcontractors, the risks involved, due to inability or failure on the part of subcontractors to perform satisfactorily, rest entirely with the prime contractor who is generally paid to assume this risk.

While this approach appears logical and quite adequate for those subcontractors supplying routine, commercial, off-the-shelf components, the Government is faced with a

different situation when subcontractors are obtained to design and develop complex, highly technical, sub-assemblies for major weapons systems. Lacking "privity of contract" with subcontractors, the Government is unable to establish those direct legal and regulatory relationships, discussed previously, designed to protect and foster Government concerns and interests regarding subcontractor performance. The Government's solution to this dilemma has been the gradual evolution of a series of indirect relationships established with subcontractors designed to safeguard the buyer's interests and obtain the needed visibility and control over subcontracting efforts while simultaneously avoiding "privity of contract" with its inherent responsibilities and additional risk exposure. Chapter IV will outline, in detail, the makeup of such relationships created by the intricate involvement of Government, prime contractors, and subcontractors.

III. BACKGROUND

Prior to World War II, the subject of Government - subcontractor relationships, as well as prime contractor - subcontractor relations, did not significantly impact on the success or effectiveness of the Federal acquisition process. In those days, only a limited number of weapons development programs were being pursued, relatively few dollars were expended in this regard, and weapons design, development, and production were achieved primarily by the Army using Government personnel, plant, and equipment. With the outbreak of World War II, however, the need for weapons increased dramatically. In addition, the ability to reduce development and production leadtime became critical so as to deploy required weapons to the field as quickly as possible. The result was an overtaxing of Government weapons facilities and an increasing reliance on commercial industry to design, develop and produce new weapons and technology.

In addition, the Government found itself lacking the acquisition instruments and methodologies necessary for the acquisition of weaponry from commercial enterprise. Professor John Wm. Whelan, Professor Law, Georgetown University Law Center states: [50:p.xix]

> Most of the "law" and regulations dealing with Government contracts and most of the rules followed by Government personnel making and administering contracts were derived from a much earlier time when they had been devised to meet

> quite different problems. When our entry in World War II faced us with a real need for revolution in Government, it found us also without a really sensible legal structure under which to conduct the business of the Government as a purchaser of war material.

To illustrate this point, procurement law at this time, with its emphasis on formal advertising, was designed primarily to procure items with stable production and price history using precise specifications. This situation was not conducive to the procurement of new weapons systems often identified only by performance characteristics, much less design specifications. Consequently, the First War Powers Act of 1941, was passed which authorized the War and Navy Departments to enter into contracts with industry without compliance with the statutory requirement for formal advertising; thus ushering in the age of negotiated procurement.

After the war, a continuing need for commercial involvement in the creation of new weapon systems was realized as the United States entered the nuclear age and the "cold war" period; both of which placed a premium on the nation's ability to protect and defend itself through the development and production of modern efficient weapon systems. This fact, combined with the need to upgrade and enlarge the legal basis for the procurement of weaponry, led to the Armed Services Procurement Act of 1947. This Act stated the principal rules for the making of contracts with industry, for contractor reimbursement (types of contracts) and for other ancillary phases of contract making. Some of the provisions of this Act include, but are not limited to, the following: [30:p18-20]

1. The policy that a fair portion of purchases and contracts be placed with small business concerns.
2. The provision that purchases and contracts be made by formal advertising in all cases in which such method is feasible.
3. An enumeration of situations in which procurement by negotiation is appropriate.
4. The delineation of procedures for formal advertising such as full and free competition, public opening of bids, the necessity for responsiveness for bids, etc.
5. A prohibition against use of the cost - plus - percentage of - cost type of contracting.
6. A requirement for a determination and finding before a cost contract or incentive contract can be awarded.
7. A limitation on the fee payable under a CPFF contract.
8. The requirement for approval of certain subcontracts.
9. An authorization of progress payments.
10. A reservation of the Government's right to examine prime contractors and subcontractors' books and records related to negotiated contracts.

This Act also authorized the issuing of the Armed Services Procurement Regulation (ASPR), now Defense Acquisition Regulations (DAR), which outlines uniform regulations and principals to be followed within DOD when contracting with private industry. In turn, ASPR was soon supplemented by each Military

Department via individual service directives, procedures and supplements.

The modern instruments which form the basis for the statutory and regulatory relationships between Government, and at least, prime contractors were therefore basically in place by the end of the 1940's. However, as modern weapon systems advanced, with regard to technology and complexity, and became ideal candidates for one of the seventeen exemptions to the formal advertised procurement approach, as authorized by the Armed Services Procurement Act of 1947, additional problems developed for the Government. With the dawn of negotiated procurement, dawned also the age of increasing uncertainty, unknowns, and risk for both buyer and seller alike; of reduced competition and the resultant loss of confidence in cost data; and of increasingly large expenditures of public funds for weapons design and development. By 1971 less than 12% of defense procurement actions were awarded through formally advertised competitive procurement; the remaining 88% were awarded through negotiated procurement. No more than 25% of the negotiated procurements were conducted in situations where more than one contractor was a contender for the award. Thus no more than 37% of defense procurement actions were awarded through competition of any form [18; p. 256]. Given this situation, as it evolved through the fifties and sixties, the Government's response was not to change basic relationships with prime contractors but to strengthen and widen the score of these relationships through additional statutes, regulations

and directives. Statutes covering cost and pricing data (Truth in Negotiations Act), cost accounting standards (P.L. 91-379), as well as recent policies covering the acquisition of major weapon systems (Office of Management and Budget Circular A 109) are just a few examples of additional policies, regulations and procedures placed on industry by Government in an attempt to broaden the scope of these basic relationships. This trend has continued through the seventies until presently it is estimated that approximately 4,000 statutes apply to the Federal acquisition process, along with countless regulations and requirements from the Office of Federal Procurement Policy (OFPP), DOD, Military Department Headquarters, procuring agencies and field procurement activities.

While there can be no question that to protect, safeguard, and foster Government procurement interests and objectives, the Federal procurement process has grown steadily and basic relationships encompass more situations than ever before, an even more interesting phenomenon has occurred with respect to subcontractors.

As the Government began to rely more and more on private industry for the design and production of weapon systems, the subcontractor initially assumed a secondary or supplemental role, far less important than the critical role assumed today. Early weapons requirements were relatively simple in design and most work assigned to prime contractors was performed by the prime contractor himself. Occasionally, prime contractors

would utilize subcontracts to perform overflow type work when prime contractors lacked adequate plant capacity. Subcontractors were generally small companies who possessed the plant capacity and limited skills necessary to build subsystems, provided the prime contractor supplied detailed specifications. The more detailed sub-assemblies and accessory equipments were contracted for directly by the Government and supplied to the prime contractor as Government furnished equipment (GFE) or major components were supplied to a Government facility for assembly into the final product. For example, aircraft components such as engines, electronic items, landing gear etc., were ordinarily provided to the airframe contractor as GFE. Ammunition components, however, have traditionally been supplied to Government facilities for assembly. In the former case, it should be noted that the contractor to whom components were supplied as GFE carried no responsibility either with regard to performance or successful integration of major sub-systems and components. All risk was shouldered by the Government along with the added burdens and expense of having to solicit, award, and administer prime contracts for the various components required.

As the sophistication of modern weapons advanced, complex sub-assemblies and components were required which had to be successfully integrated to achieve a viable finished product. For example, a modern fighter aircraft must integrate the basic airframe with a complex missile system, a complex guidance and control system and a sophisticated test equipment

package in order to realize an effective fighting entity. With these new requirements and realities came a more essential role for prime and subcontractors alike.

The Government, during this transition, began to experience difficulty in obtaining and holding the management and technical talent needed to oversee the complexities being encountered with the more modern systems. In addition, the increase in Government resources required to aware and administer contracts for direct procurement of increasingly complex and more numerous components became prohibitive. Furthermore, additional risk accrued to the Government when integration of newly designed and developed GFE was attempted into a total system.

To combat these new difficulties, the Government developed the concept of the integrating weapon system contractor. Under this concept, a prime contractor is selected who is totally responsible for managing and delivering an entire weapon system including related components, accessory equipment and supporting facilities. While adoption of this concept alleviated many problems experienced by the Government, and shifted the risk of integrating major components to the selected weapon system contractor, it also caused problems for prime contractors. No one contractor could hope to have all the skills, facilities or talent in-house needed to successfully complete these major projects. Subsequently, prime contractors began to contract directly with subcontractors, not just for standard, off-the-shelf overflow

requirements as before, but for complex design, development and production of major system components. Furthermore, prime contractors began to utilize subcontractors to stabilize in house skills and facilities. Awarding subcontracts allowed prime contractors flexibility in coping with the often accordian-like requirements of DOD acquisition, as the number of subcontracts could be increased or decreased as Defense spending increased or decreased. This allowed prime contractors to maintain their facilities and personnel at prescribed levels; reducing costs and increasing efficiency.

As the number of Government prime contracts were reduced, more subcontracts were awarded by weapon systems contractors increasing the flow of taxpayer dollars to subcontractors. In many instances first tier subcontractors awarded subcontracts to others thereby further disbursing public funds over an even wider range of private industry. With increased dollars flowing to subcontractors, many large corporations began to accept work as subcontractors on some projects as well as functioning as the prime contractor on others.

As increasingly complex contracts, involving greater uncertainty and risk, flowed to subcontractors, along with vastly enhanced sums of taxpayer dollars, the Government found itself lacking the relationships with subcontractors necessary to invoke policies and regulations designed to achieve the management and control functions previously enjoyed when major components were contracted directly. While the weapon systems contractor concept calls for prime contractors to select,

administer and effectively manage their subcontractors, the Government has not been content to let prime contractors remain totally autonomous in this regard. The increased risks and uncertainty created for the Government, when millions of dollars are awarded to subcontractors with whom the Government has no contractual relationship, has lead to a feeling of uneasiness as to the Government's control over critical major subcontractor efforts. This feeling has been compounded and reinforced by failure, in some cases, of prime contractors to effectively manage subcontractor performance thereby leading to program deficiencies, unwarranted cost growth, and schedule slippages.

Therefore, starting with a statutory requirement for advance notification by prime contractors concerning the award of certain subcontracts, the Government has created a series of indirect relationships with subcontractors designed to invoke additional Government control and visibility over these new key players in the acquisition arena. Throughout the fifties, sixties, and seventies, as the role of the subcontractor has increased in importance, these indirect relationships have been expanded through increased statutory requirements placed on subcontractors, the creation of mandatory flow-down clauses in Government - prime contracts which must be passed on to subcontractors and increased Government surveillance and monitoring at subcontractor facilities. Additionally, the Government has strengthened its control over the prime contractor's ability to place subcontracts

trhough reviews of the prime contractor's "make or buy" plan, reviews of prime contractor's procurement system, and reviews of prime contractor's proposed subcontract management organization and procedures.

While it will be left for Chapter IV to provide a detailed delineation of current Government - prime contractor - subcontractor relationships, it is apparent that as the nature of the Federal acquisition environment has changed, so too have Government mechanisms and methodologies designed to further Federal acquisition objectives and acquire the best buy per dollar expended. Whether existing relationships have been broadened and expanded in scope, as with prime contractors, or new, indirect, and less tangible relationships constructed, as with subcontractors, the Government's need for visibility and control over the efforts of those designated to provide public goods and services has been demonstrated as well as the Government's insistence that the necessary visibility and control, in fact, be achieved. As with most change, however, the evolutionary process of altering, and expanding, and creating Government industry relations has not occurred without problems. Doubts and controversy as to whether current relations are fair and equitable to all parties concerned as well as whether the acquisition process has been helped or hindered via increased Government regulations and intervention have been voiced; particularly with regard to subcontractors. These aspects will be addressed in Chapter V.

IV. GOVERNMENT - PRIME CONTRACTOR - SUBCONTRACTOR RELATIONSHIPS

A. GOVERNMENT - PRIME CONTRACTOR RELATIONSHIPS

Government - prime contractor relationships are relatively simple, and straightforward; characterized by "privity of contract." In other words, the contractual instrument is utilized as the vehicle by which a legally binding relationship is formed between the immediate parties to the contract. By agreement as to the clauses contained within the contract, both parties assume and acknowledge duties and responsibilities which must be carried out. In addition, failure to carry out stated responsibilities by either party may result in the injured party exercising administrative or judicial rights leading to recoupment of damages or a release from the legal relationship.

It also must be recognized that statutory relationships exist between the Government and prime contractors because Federal procurement law applies to those engaged in the Federal procurement process simply because it is the law. While it is customary to include statutory requirements as mandatory contract clauses within the contractual instrument, the duties, responsibilities and rights provided for in a Federal procurement statute apply whether specifically designated by the contractual instrument or not. In fact, the Federal judicial system has taken this statutory relationship one step further. Under the Christian case (20) it was ruled

that mandatory provisions of DAR, be they derived from statute, executive order or agency regulation, have the force and effort of law, as DAR itself is derived from statutory authority. Therefore, whenever, a mandatory provision of DAR is applicable to a contract it becomes part of any resulting contract by operation of the law. This is true even where such a provision is not actually an express part of the contract [43; p. 625].

This strong statutory and legal relationship, as well as the more intangible relationships involving Government leverage and bargaining strength due to its position as a monopsony, provides the Government an excellent mechanism for achieving the desired control, visibility, and managerial input required to protect its interests and foster sound acquisition practices when dealing with prime contractors.

B. PRIME CONTRACTOR - SUBCONTRACTOR RELATIONSHIPS

Prime contractor - subcontractor relationships are similar to those established between the Government and prime contractors. Again, a direct legal relationship is established between the immediate parties which serves to outline the duties, responsibilities, obligations and legal remedies available to those involved. Prime contractor - subcontractor relations do differ somewhat from Government - prime contractor relationships in that, although subcontractors are at times subject statutorily to Government controls, the relationship between a prime and his subcontractor is established primarily

by a commercial contract between private parties and as such is subject to the normal rules of commercial contract law [16; p. C-9]. The rules of commercial contract law are embodied in the Uniform Commercial Code (UCC); a body of commercial contract law designed to facilitate the commerce of the country through a uniform set of laws which strive to [16: p. C-2]

1. Simplify, clarify and modernize the law governing commercial transactions.
2. Permit continued expansion of commercial practices through custom, usage and agreement of parties.
3. To make uniform the law among the various jurisdictions.

As there is no formally adopted Federal commercial code, the UCC is therefore effective only in those states which have adopted it as law. At present, however, every state except Louisiana has in fact accepted the UCC within its jurisdiction.

Whether the legal relationship between parties is governed by Federal contract law, regulations and policy, or by accepted commercial law, the primary point is that "privity of contract" exists in both relationships. This affords the concerned parties in both situations direct, legally enforceable avenues through which desired duties and responsibilities, with regard to one another, may be delineated as well as legal remedies in the event either party fails to comply with agreed-to provisions of the contractual instrument.

C. GOVERNMENT - SUBCONTRACTOR RELATIONSHIPS

Probably, the most important difference between the relationship established between the Government and subcontractors, and those relations previously discussed, is the fact that there is no "privity of contract" between the Government and subcontractors selected by prime contractors engaged in Federal acquisition programs. As there is no direct contractual relationship, express or implied, there is also absent any delineation or basis for rights, responsibilities, duties or legal remedies between the Government and subcontractors. However, it has been alleged that as useful as lack of privity may be to the Government in forcing prime contractors to shoulder the managerial risks of chosen subcontractors, as well as to shield the Government from direct subcontractor claims, privity does not always provide the subcontractor with a shelter against Government action. In the words of Professor John W. Whelan and George H. Gnoss: [51; p. 681]

> Statutes, regulations, and contract terms give the Government rights against subcontractors which in the case of many subcontracts, make the "wall of privity" rather like a one way swiss cheese or perhaps more aptly, like one of those walls used in experimentation with radioactive materials through which the experimenter can act by means of remote control devices all the while being shielded by the wall from the effects of radiation.

Even though no direct contractual relationship exists between the Government and subcontractors, the Government has achieved a great degree of control over the subcontracting function.

Government control and visibility with regard to subcontracting actually begins long before a prime contractor awards his first subcontract and, in certain cases, even before the prime himself receives a contract award. In accordance with DAR, the Government has the right to review a prime contractor's "make-or-buy" plan [10; Sect. III; pt.9]. Such a plan identifies the major subsystems, assemblies, sub assemblies and components to be made in the prime's facilities and those to be obtained elsewhere by subcontracts. In evaluating proposed make-or-buy plans, the following factors are considered [10; Sect. III; pt. 9]

1. The effect of the contractor's proposed make-or-buy program on price, quality, delivery, and performance.

2. Whether the contractor has justified the performances of work in plant the nature of which differs significantly from his normal in-plant operations.

3. The consequences of the contractor's projected plant work loading with respect to overhead costs.

4. Contractor consideration of the competence, ability, experience, and capacity available in other firms, especially small business or labor surplus area concerns (this is particularly significant if the contractor proposes to request additional Government facilities in order to perform in-plant work).

5. Contractor's make-or-buy history as to the type of item concerned.

6. Whether small business and labor suprplus area firms may be able to compete for subcontracts.

7. Other factors, such as the nature of the items, experience with similar items, future requirements, engineering, tooling, starting load costs, market conditions, and the availability of personnel and materials.

Through its relationship with the prime contractor, the Government is therefore able to decide, or at least have a say, as to whether contemplated subcontracts are in the Government's best interest and should be subsequently pursued. Assuming a prime contractor's proposed make-or-buy plan is approved, further Government control over proposed subcontracts is afforded via the contractual right to consent and approve subcontracts meeting specified criteria [10; 7-104.23, 7-203.8]. While the requirements which determine when consent is required vary with the type of contract, basically consent is required under fixed-price prime contracts when proposed subcontracts are cost-type contracts, or exceed $100,000 [10; 23-201.1]. Under cost type prime contracts, consent is required for proposed subcontracts of a cost type, fixed-price subcontracts exceeding $25,000, or 5% of the contract, or provides for the fabrication, rental installation, or other acquisition of special test equipment having a value in excess of $1,000 [10; 23-201.2]. The primary purpose of the requirement for consent is to help assure the Government that prime contractors are procuring materials and components with the best interests of the Government in mind and that the prime contractor's procuring practices embody the same basic principles as used by the Government in acquiring the services of prime contractors. The following factors shall be considered for the purpose of granting consent [10; 23-202(a)]:

(i) the technical justification for selection of the particular supplies, equipment, or services;
(ii) whether the decision to enter into the proposed subcontract is consistent with the contractor's approved "make-or-buy" program, if any (see 3-902);
(iii) whether the proposed subcontract will require the use of Government-furnished facilities and, if so, whether proper consideration has been obtained;
(iv) the responsibility of the proposed subcontractor (see 1-906);
(v) the basis for selecting the proposed contractor, including the price competition obtained;
(vi) any cost or price analysis or price comparisons accomplished, with particular attention to whether cost or pricing data are accurate, complete, and current, and to whether any required certification has been obtained (see 3-807.3 and 7-104.42);
(vii) the effectiveness of subcontract management by the prime contractor;
(viii) the appropriateness of the type of subcontract used (see Section III, Part 4)
(ix) the estimated total extent of subcontracting, including procurement of parts and materials;
(x) the extent to which the prime contractor obtains assurance of the adequacy of the subcontractors' procurement system;
(xi) availability from Government sources of industrial facilities or special test equipment (see Section XIII, Part 3);
(xii) whether consideration was given to the solicitation of small business and labor surplus area as subcontract sources; and
(xiii) the extent of compliance with Cost Accounting Standards in the awarding of subcontracts.

In addition, DAR states that careful and thorough evaluation is particularly necessary when [10; 23-202(b)].

(i) the prime contractor's procurement system or performance thereunder is considered inadequate;
(ii) subcontracts are for items for which there is no competition or for which the proposed prices appear unreasonable (see 3-807.10(b));
(iii) close working arrangements or business or ownership affiliations exist between the prime and the subcontractor which may preclude the free use of competition or result in higher subcontract prices than might otherwise be obtained;
(iv) a subcontract is being proposed at a price less favorable than that which has been given by the subcontractor to the Government, all other factors such

as manufacturing period and quantity being comparable; or

(v) a subcontract is to be placed on a cost-reimbursement, time and materials, labor-hour, fixed-price incentive, or fixed-price redeterminable basis.

While the reasons behind Government consent to proposed subcontracts are certainly valid and understandable, problems arose with this practice as the number of subcontracts increased and more and more met the criteria for consent. Several interviewees stated that the time required to consent to individual subcontracts soon became prohibitive and brought complaints from industry that programs were being unduly delayed. To alleviate this problem, the Government, following the lead of the Air Force, instituted the Contractor Procurement System Review Program (CPSR). The intent was to take a systems approach in determining whether a prime contractor's procurement practices were sufficient to safeguard and further Governmental interests and objectives as opposed to individual reviews of each subcontract document. Currently, DAR outlines the program objectives as follows [10; 23-100]:

(i) a means for evaluating the efficiency and effectiveness with which the contractor spends Government funds;

(ii) the basis for the administrative contracting officer (ACO) to grant, withhold, or withdraw approval of the contractor's procurement system;

(iii) reliable current information to the procuring contracting officer (PCO) on the contractor's procurement system for use in source selection, determining appropriate type of contract, and establishing profit and fee objectives;

(iv) an independent review of the contractor's procurement system to optimize its effectiveness in complying with Government policy; and

(v) current procurement system information for appropriate Department of Defense activities in areas of Government interest. (See Supplement No. 1 for procedures for conducting a CPSR.)

Furthermore, DAR states that an initial review will be made of a contractor's purchasing system when he is expected to have sales to the Government in excess of five million dollars during the next twelve months on other than firm fixed-price (FFP) contracts and fixed priced contracts with economic price adjustment provisions [10; 23-101]. In addition, DAR states that consideration shall be given to the conducting of a CPSR when sales to the Government on noncompetitive negotiated contracts, regardless of contract type, are expected to exceed five million dollars [10; 23-101].

The ACO is responsible for granting, withholding or withdrawing CPSR approval based on the findings of the review. Furthermore, DAR provides for an initial review along with annual reviews covering areas of interest or weaknesses discovered [10; 23-101]. Special reviews of approved systems may also be held whenever weaknesses are revealed or suspected. While detailed procedures for conducting CPSR's are contained in ASPR Supplement No. 1, "Guide for Conducting Contractor Procurement System Review" the following criteria will be given special attention as per DAR [10; 23-103(9)].

(i) the degree of price competition obtained;
(ii) pricing policies and techniques, including methods of obtaining accurate, complete, and current cost and pricing data, and certification as required (see 3-807.3, 3-807.4, and 7-104.42);
(iii) the methods of evaluating subcontractors' responsibility (see 1-906);
(iv) the treatment accorded affiliates and other concerns having close working arrangements with the contractor;
(v) the extent to which assurance is obtained that principal subcontractors apply sound pricing

practices and a satisfactory procurement system in dealing with lower-tier subcontractors;

(vi) the appropriateness of the type of subcontract used (see Section III, Part 4);

(vii) practices pertaining to small business and labor surplus area programs (see Section I Parts 7 and 8);

(viii) attention given to the management of major subcontract programs; and

(ix) compliance with the Cost Accounting Standards in awarding of subcontracts (see Section III, Part 12).

While approval of a prime contractor's procurement system generally waives notification, approval and consent requirements for most subcontracts, it should be noted that written consent and approval to certain classes of subcontracts may still be required because of their critical nature or particular circumstances call for extraordinary Government surveillance [10; 23-105(d)].

Government involvement in the subcontracting process by no means ends with the reviews conducted prior to a prime contractor awarding a subcontract. Much of the control and visibility achieved by the Government over subcontractor actions and efforts, are achieved through clauses which appear in the prime contractor's contract and are subsequently incorporated in the subcontract. Clauses such as these are referred to as flow-down clauses and may or may not be mandatory.

In the case of mandatory flow-down clauses, prime contractors must agree to include these clauses in any subcontracts as a condition of their contract with the Government. A 1971 Aerospace Industries Association (AIA) study delineated these clauses, applicable to subcontractors, that are mandatory in nature as well as those included in subcontracts for the

primes' self protection [1; p. 38-40]. Examples of mandatory flow down clauses, covering the following areas, include, cost and pricing data requirements, utilization of small business concerns, utilization of labor surplus area concerns, equal opportunity requirements, examination of records, consent to subcontracts, excess profit, military security requirements, and basic data and patent rights.

In addition, certain clauses are flowed down to subcontractors by prime contractors not because the Government legally requires it, as with mandatory flow-down clauses, but because prime contractors have agreed to similar clauses within their Government contract. Clauses such as these must be applied to subcontractors to protect prime contractor interests and ensure compliance with all Government provisions and obligations placed on prime contractors. The Government also benefits in this situation as certain Government requirements become applicable to subcontractors as prime contractors seek to protect themselves. For example under the Changes Clause, the Government can make unilateral changes with respect to specifications, delivery destination and packaging requirements for items being acquired under defense contracts. Prime contractors must attempt to achieve the same provisions with subcontractors or face the prospect of being unable to comply with Government change orders which effect subcontracted components or be faced with attempting to negotiate bilateral changes with subcontractors which they may legally refuse to

perform. Given this situation, a subcontractor may also be tempted to charge an exhorbitant rate for instituting the change knowing the prime contractor faces default unless the subcontractor delivers. Therefore, prime contractors flow-down a changes clause to subcontractors to protect themselves and, in the process, the Government's right to make unilateral changes is extended to subcontractors as well as prime contractors even though there exists no legal vehicle between the Government and the subcontractor by which to achieve this right. A further example is provided by the Quality Assurance Clause [10; 7-104.28]. The Government, in its relationship with prime contractors, dictates a particular quality assurance program based on the complexity and requirements of the proposed weapon system. In order to meet this contractual provision, prime contractors must flow-down this requirement to major subcontractors whose components are integrated into the total system. Once again, the Government has realized its objectives at the subcontractor level without establishing a direct, legal relationship through which to convey its demands.

Whether clauses are applied to subcontractors because they are mandatory, or because a prime contractor must insist on them to enable him to comply with the provisions of a Government contract, the result is the same; Government objectives and requirements reach not only prime contractors but are effectively applied to subcontractors as well.

It should also be noted that flow-down clauses authorize Government visibility into subcontractor operations as well

as furthering Government procurement practices and objectives. The Inspection Clause [10; 7-203.5] which provides for Government inspection at all times and places, including source inspection at subcontractor facilities, the Examination of Records Clause [10; 7-104.15] which allows Government auditors to examine subcontractors books and accounting data, and the Cost and Pricing Data Clause [10; 7-104.42] which allows auditors to verify that subcontractor cost and pricing data are in fact current actual and complete, are all examples of clauses which authorize Government visibility with respect to subcontractor efforts and activities. These visibility functions are physically achieved by either permanently stationed CAO or DCAA personnel within the subcontractors plant or the use of a secondary CAO visit request. The former situation usually occurs when a subcontractor also performs a good deal of prime contract work and may have CAO personnel in his plant fulltime to monitor his prime contract functions. These same personnel can also assist with subcontractor monitoring and surveillance functions if and when required. The later situation may occur with smaller subcontractors who have no permanently assigned CAO personnel. In this case, the CAO for the prime contractor contacts that CAO activity nearest the subcontractor's plant and requests surveillance assistance. A CAO representative is then sent to perform the required function and reports back to the requesting activity. In either case, the Government's right to visibility as achieved by flow down provisions, is

invaluable in observing subcontractor efforts and operations. While CAO personnel are forbidden from directing the actions of subcontractors, as that is the prime contractor's responsibility, they can observe subcontractor practices and procedures as well as how the prime contractor is implementing and applying Government flow-down requirements. Any deficiencies or potential problems can subsequently be reported to the prime contractor, Project Manager, or procuring activity for quick and effective action by both the prime contractor and subcontractor responsible. With this visibility, it is hoped prime contractors are motivated to properly monitor and manage the efforts of subcontractors because they know Government personnel can ascertain whether the prime contractor is performing the subcontract management functions he is contractually required to accomplish.

Further relationships between the Government and subcontractors occur when duties and requirements, ordinarily the responsibility of the prime contractor, can't be effectively accomplished. For example, under the Cost and Pricing Data Clause it is the prime contractor's responsibility to verify that subcontractor cost and pricing data is accurate, current and complete. However, prime and subcontractors may be competitors on future contracts and the subcontractor may refuse the prime contractor access to his accounting records and those elements which constitute his overhead and general and administrative (G&A) rates. In this case, Government auditors must intervene, audit the subcontractor's data, and, while not

divulging specific information, inform the prime contractor as to the reasonableness of the proposed rates. In a similar situation, where the Government requires both prime and subcontractors to furnish all proprietary data generated through Government funded research and development, subcontractors may refuse to submit this data to prime contractors for fear it may be acquired by prime contractors for their own future use. The Government has allowed subcontractors to submit this data directly to the procuring activity in these situations. Finally, subcontractors may attempt to establish informal relations with Government procuring activities by bringing to the Government's attention problems being experienced with prime contractors, such as failure to receive payments in a timely fashion or the occurrence of seemingly unfair and inequitable practices on the part of prime contractors. Technically, the Government's official position is not to get involved in affairs between prime contractors and their subcontractors, as the Government pays for the prime contractor's managerial ability in these situations. However, it must be remembered that the primary objective is to acquire an acceptable weapon system, on time, at an affordable cost. To the extent that prime contractor and subcontractor differences may jeopardize these objectives it may behoove the Government to intervene, even though it is recognized that Government action is limited due to the fear of shifting risk from the prime contractor to the Government. Usually, the Government serves only to elevate the problem to a higher

level in both the prime and subcontractor organizations or the Government initiates action to bring the parties together so that suggested solutions to the problem at hand may be offered. Nevertheless, informal relationships are developed in these situations through which the Government attempts to control, monitor, and influence prime and subcontractors alike in the pursuit of Government needs and objectives.

In summary, Government-subcontractor relationships are nebulous, vague and less tangible than relations established between the Government and prime contractors or between prime contractors and subcontractors. Nevertheless, the Government has felt it necessary to establish the procedures and mechanisms described to influence the direct prime contractor-subcontractor relationship, as well as maintain some degree of visibility and control over key prime contractor suppliers, thereby creating at least an indirect relation with subcontractors. Even though less formal or tangible than direct relationships, Government-subcontractor relations appear to effectively foster Government interests, help safeguard public funds, extend Government procurement practices to prime contractors and obtain Government surveillance and monitoring functions over subcontractor efforts.

While these relations appear necessary and justified, at least from the Government's standpoint, research indicates they may still fail to achieve the degree of Government management control desired by some program managers, cause problems in the delineation of authority for subcontractor

functions between Government and industry, lead to abuse of subcontractors by prime contractors, and deny subcontractors legal remedies for Government actions or inactions which are available to prime contractors. Discussion and analysis of these problems will be addressed in the next chapter.

V. PROBLEMS INHERENT IN THE RELATIONSHIPS

A. PREFACE

One of the principal reasons for undertaking this effort was an attempt to determine what types of problems and difficulties may be created due to present Government policy, regarding relationships with critical subcontractors, within the weapons system acquisition process. Through problem identification and analysis it was hoped that suggested changes and alterations to present practices might ensure; thereby enhancing the effectiveness of the Government acquisition process and simultaneously fostering the goals and objectives of Government and industry alike.

While there appears to be a multitude of minor problems, or more aptly minor annoyances, regarding present relationships, this chapter will concentrate on the major, generally widespread, problems as perceived by both Government and industry alike.

B. GOVERNMENT PROBLEMS

As a broad generalization, interviews with Government acquisition officials, particularly policy makers, indicate a high degree of satisfaction with current Government - prime contractor - subcontractor relationships. It was expressed that Government objectives are being effectively achieved, prime contractors are assuming "public responsibility" for

the judicious expenditure of taxpayer dollars when subcontracting, and the desired visibility and monitoring of subcontractor efforts is occurring. These general objectives tend to reinforce and further support the findings of the Commission on Government Procurement (COGP) which, in 1971, was organized to study the Government acquisition process in an attempt to identify problems and recommend solutions for improvement. Within the COGP, Study Group Eight looked specifically at the area of subcontracting and Government, prime contractor, subcontractor relationships and interrelationships. This group found "prime contractors and Government officials basically are satisfied with the status quo. Each believes the present system essentially advantageous to its objectives" [6; p. 351]. This fact notwithstanding, it is perceived, based on personal interviews and literature, that problems may well exist for the Government in this environment, particularly in the area of subcontract management.

1. Subcontract Management

The primary area of concern for the Government, with respect to current relationships, appears to concern itself with how best to handle subcontract management, or better yet, how to encourage and incentivize prime contractors to manage their subcontractors more efficiently and effectively. Government - subcontractor relations, while considered effective by many, are still indirect in nature and lack "privity of contract." This means Government PM's, PCO's and ACO's do not possess

direct managerial control nor legally enforceable methods by which to dictate or direct subcontractor efforts. Instead, the Government can assume only a monitoring and surveillance role with respect to subcontractors and must rely on an intermediate party - the prime contractor - to act and think like the Government when engaging in the management of subcontractors. If the prime contractor performs well, with regard to subcontract management functions, then the system works as it should. Prime contractors protect Government interests through diligent, well planned subcontract management and the end result is the successful integration of major components into the total system without quality, delivery or cost problems. However, according to Government officials, not all prime contractors are successful, effective and diligent in pursuit of sound subcontract management practices.

There also appears to be some question as to whether prime contractors are effectively incentivized to perform subcontract management functions. Under a Firm Fixed-Price (FFP) subcontract, prime contractors may be tempted to sit back and let the subcontractor perform with little or no surveillance knowing that the risk is on the subcontractor because he receives no payment until an acceptable product is delivered. Unfortunately, from the Government's standpoint, the fact that a subcontractor receives no payment for an undelivered or unacceptable product is of little consolation if subcontractor problems or failure results in

costly program delays, technical inefficiencies, and spiraling cost growth while the prime contractor either attempts to "bail-out" the troubled subcontractor or search for an additional source of supply.

Under cost-type subcontracts, which are seen primarily when the prime contractor also has a cost-type contract, it is again found that prime contractors may have less incentive to effectively manage subcontractors. Subcontractor inefficiency, poor management practices, and technical deficiencies, which manifest themselves in increased program cost, and schedule slippages, are merely passed back to the Government under the cost-type arrangement between the Government and the prime contractor. While the use of more FFP prime contracts, as well as fixed-price incentive type contract arrangements, forces prime contractors to pay more attention to subcontractor's performance, these instruments are not always applicable in many design and development projects early in the acquisition cycle.

While this is not to say that prime contractor mismanagement of subcontractors is so blatant or irresponsive as to result in the default of the prime contractor or so damage his image as to effectively preclude future awards, improvements in prime contractor management of subcontractors may be feasible in many cases.

In an attempt to encourage and foster improvements in this regard by prime contractors, and to ensure Government

interests are adequately protected, perhaps Government involvement in subcontractor efforts is justified. However, due to established Government acquisition policy it is the prime contractor's responsibility to manage subcontractors so that all risk created by subcontractor problems or failures is born by the prime contractor. Therefore, the Government is relegated to a role where it monitors the effectiveness of subcontractor efforts, as well as the prime contractor's management of his subcontractors, but is restrained from the actual direction of subcontractor efforts. This policy is necessary to preclude the shifting of risk back to the Government due to intervention and interference into an area specifically the responsibility of the prime contractor. The Government's problem then is to effectively monitor and direct prime contractor efforts to manage subcontractors and protect Government interests but refrain from any direct intervention with subcontractors which may remove responsibilities assigned to prime contractors and place them back on Government shoulders. This position often becomes a difficult tightrope to walk, particularly, by PM's and program office personnel charged with overall responsibility for total weapon system design, development and production but lacking direct authority over the actions of some 50 to 70% of those performing the work.

Given this delicate situation, it appears that one way in which the Government has chosen to tackle this dilemma is to incentivize prime contractors to better achieve what

they are being paid for in the first place as well as penalize them for their failures. Hopefully this will result in less need for Government engagement with regard to subcontractors. More than one program manager, for example, has expressed support for the use of award fee contracts to incentivize contractors engaged in the design and development of major weapon systems. Under this concept, a prime contractor's award fee is not fixed but based instead on his performance in certain functional areas determined by the Government. Common functional areas, on which award fee may be based, include technical proficiency, management capabilities, cost control, and ability to meet or exceed schedule requirements. By assigning fee percentages, based on target cost, to each of these areas the Government may then award all or part of the fees assigned to each functional area based on actual performance. For example, consider a proposed weapon system contract with a target cost of one million dollars and a five percent fee assigned to technical proficiency. If the Government felt that the contractor had performed exceptionally well in this area, the contractor could receive as much as $50,000 in fees. On the other hand, poor performance could result in zero fee for this particular area.

As subcontract management is often included under the general management functional area, larger award fee percentages placed here might serve to further reward firms who effectively manage their subcontracts, as well as penalize to a greater degree, those who exhibit poor subcontract

management practices. As an additional alternative, a separate subcontract management functional area might be established as well as the customary areas considered currently.

While this concept has merit, it also has its drawbacks. From an industry standpoint, the determination as to fee is made entirely by Government personnel and is considered extremely subjective. In addition, award fee determinations, which are usually made by the PM, based on the recommendation of a fee determination board, are non-appealable. Industry has expressed concern as to the potential for arbitrary treatment in the awarding of profit under this concept.

Another means of achieving enhanced subcontract management, on the part of prime contractors, is through effective and efficient subcontract management programs designed to monitor and oversee the efforts of prime contractors as well as verify those efforts at subcontractor locations. While the concept appears sound, there is presently little guidance from DOD as to the nature and extent of surveillance deemed necessary or desirable. The result has been that the CAO organizations of each Military Department, are performing that level of subcontract management they deem suitable. DCAS, and its field offices basically perform those functions outlined in DAR, such as consent to subcontracts when required, CPSR reviews, and occasional

secondary visits to subcontractor plants, at the request of prime contractor CAO personnel. Here, such functions as quality inspections, production reviews, and audits are performed. The Navy, in addition to the functions mentioned above, has taken the concept of subcontract management one step further. Each Naval Plant Representative (NAVPRO) and Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP) must establish and maintain a suitably selective and flexible program providing for continuous and comprehensive surveillance of the contractor's procurement system [48]. This plan is intended to encompass all aspects of the contractor's procurement system and all operations which impact on the prime contractor's procurement including, but not limited to, determination and definition of requirements, purchasing, estimating, financing progress payments, reimbursement of costs, engineering, qualification approval, priorities and allocations, schedules and delivery dates, expediting, transportation, quality assurance, reliability, maintainability, test requirements, production, material control, Government property, provisioning, repair parts, plans, technical manuals, industrial security, make-or-buy decisions, small business, labor surplus and minority business enterprises programs. Additionally, particular emphasis should be given to the flow-down of prime contract provisions and, where applicable, the requirements of P.L. 87-653, "Truth-in-Negotiations."

Significant areas for surveillance area as follows [48]:

(1) Drawings, plans and specifications properly reflect contract requirements including those related to performance, quality, maintainability and reliability.

(2) Quantities ordered are realistic and reflect effective material control and useage.

(3) Awards are made on a competitive basis whenever feasible.

(4) Delivery or performance schedules permit the contractor to keep his prime contract work on schedule.

(5) Cost/price analysis and negotiations result in fair and reasonable prices.

(6) Administration provides the prime contractor reasonable visibility of the subcontractor's cost, schedule and technical performance.

In addition, NAVPRO and SUPSHIP personnel are encouraged to attend contractor meetings regarding subcontractor efforts, critical subcontracts are to be identified as early as possible for special management attention (although what constitutes special attention is not specified) and contractor source selection methods must be thoroughly reviewed to ensure conformance with DOD acquisition policies [11]. Furthermore, frequent examination shall be made of the prime contractor's records regarding subcontractor cost, schedule, and technical performance.

The Air Force has further expanded subcontract management functions. Based on the fact that many past Air Force system acquisition projects had experienced trouble arising from subcontractors, as well as the fear that prime contractors were not effectively applying systems acquisition management policies to subcontractors, an Air Force System Command

Study was initiated in the early 1970's. The objectives of the study were as follows [45].

1. Determine whether the Air Force has required prime contractors to practice DOD acquisition policies and management techniques in their relationships with subcontractors.

2. Evaluate contractual instruments (government-prime and prime-sub) to assess the degree to which such requirements are reflected.

3. Evaluate the actual practices of prime and subcontractors in response to these requirements.

4. Determine the level of USAF and prime contractor management attention focused on technical, schedule, and cost performance of subcontractors.

Basic observations emanating from the study indicated that each program office managed subcontracts in its own way; some monitored closely, others didn't; program offices varied as to frequency of visits to subcontractor plants; the Air Force relied too heavily on annual CPSR's to provide checks and balances, and CPSR's relied too heavily on source selection, pricing, and technical procurement details as opposed to flow-down of acquisition policies, technical requirements, and subcontract management. One rather surprising fact was that although approximately 50% of Air Force acquisition dollars were flowing to subcontractors, only about 1% of Air Force Contract Management Division (AFCMD) personnel were devoted to surveillance of the subcontract management area.

In an effort to correct Air Force deficiencies as discovered by this study, the AFCMD was reorganized to incorporate a new functional area entitled Subcontract Management. It was felt that the Air Force Contract Management

Division Subcontract Management (AFCMD/SM) organization would consolidate staff responsibility for subcontract management and allow the AFCMD Commander an increased capability to effectively monitor and influence the management of vital subcontractors. In addition AFCMD/SM was tasked with the following functions: [44; p. 65]

(1) Support to SPO/buying office.
(2) Make-or-buy review.
(3) Purchasing system surveillance.
(4) Advance notice/consent reviews.
(5) Support administration delegation.

Aside from the subcontract management organization established at AFCMD, field level subcontract management teams were established at each Air Force Plant Representative Office (AFPRO). Duties of AFPRO/SM are the same as those delineated at the headquarters level.

The subcontract management function within the Air Force is built upon two primary principles. First, the early identification, coordinated selection, and AFPRO/SM real-time evaluation of prime contractors' management of major/critical subcontractors form the cornerstone of successful Air Force subcontract management. Second, the contractor's management of major or critical subcontractors requires the same intensity of surveillance as that provided by the AFPRO for surveillance of the contractor's total in-house operation [44; p. 65]. It can also be said that Air Force subcontract management is "dedicated" in the sense that its primary purpose is the evaluation, monitoring and surveillance of a prime

contractor's management of subcontractors. No other CAO organization was found that assigns a team the specific function of subcontractor management. Instead, in other CAO's, personnel assigned the normal contract administration functions, with regard to the management of prime contractors, assume additional duties whenever subcontract management functions arise.

It is obvious a continuum has been established regarding which tools are most effective and efficient, as well as the degree of monitoring and surveillance necessary to both promote Government interests and incentivize prime contractor's interest in subcontract management. Furthermore, where each individual organization lies on this continuum appears to be based on organizational philosophies stemming from experience and past history with regard to subcontracting problems, as opposed to any central guidance or direction from the DOD hierarchy. While individual organizational approaches to subcontract management may indeed constitute the best approach, many questions come to mind concerning such independent efforts.

Given that all three administrative organizations mentioned (DCASPROs, NAVPROs and AFPROs) are assigned administrative functions over prime contractors in which major subcontractors are intimately involved, which subcontract management approach is the most feasible, which best fosters Government interests, and which motivates prime contractors to enhance their subcontractor management efforts most effectively and efficiently? The researcher found that each administrative

organization feels their efforts in this regard are adequate and efficient to do the job. If in fact, methodologies such as consent to subcontract, performance of CPSR's, and occasional secondary visits to subcontractor facilities are really all that is required to monitor subcontractor efforts, as well as to oversee prime contractor responsibilities in this regard, then it appears the Navy and Air Force approaches waste valuable resources in time, money and personnel through unnecessary involvement. On the other hand, the Navy and Air Force feel that additional procedures, which provide a continuous real-time picture of subcontractor efforts, are needed above and beyond the one time snapshots provided by consent to individual subcontracts or CPSR. The Air Force further believes that only through a dedicated subcontract management staff, both at AFCMD and at the AFPRO, will the best real-time picture be achieved. Personnel in AFCMD/SM feel their program has been the primary reason many Air Force prime contractors have drastically enhanced their efforts in the subcontract management area and, without such a dedicated effort, the degree of subcontract management at the prime contractor level would have been substantially less. Does this mean DCAS and the Navy aren't doing a sufficient job? Could they further enhance prime contractors to pay more attention to subcontractor efforts if they adopted the Air Force methodology? Is the Air Force merely wasting men and money which could be applied more effectively in other areas? Whose approach is more effective?

2. Current Subcontractor Management Techniques

Further compounding these questions are other interesting considerations discovered during research interviews. First, it appears that consent to subcontracting may not be as effectively performed as envisioned. Discussions with ACO's, and former ACO's, indicate the depth of reviews are not as thorough and often not as encompassing as the requirements outlined in DAR, dictate.

Instead, some interviews indicate consent may consist only of a determination as to whether a proposed subcontractor is listed in Dunn and Bradstreet, what his financial rating is, and whether he is on the debarred, ineligible, or suspended list. While, hopefully, this is the extreme, such revelations do not auger well for reliance on the consent to subcontract provisions to ensure prime contractors are adequately protecting Government interests and properly applying Government requirements to subcontractors. In no case could an ACO, or former ACO interviewed, ever remember rejecting a proposed subcontract for not meeting the required criteria as outlined in DAR.

The CPSR program has also undergone changes which some feel may render it less effective. Recently, the dollar threshold used to identify those firms for which a CPSR is conducted was raised from anticipated yearly Government business of $5 million to $10 million. Furthermore, after the initial CPSR, for those firms exhibiting approved systems over the

past four years, subsequent reviews will be conducted every three years vice two years. Finally, due to personnel resource reductions, the number of CPSR personnel assigned to a review, as well as the time allotted for CPSR's, have diminished. For example, where previous requirements called for a three-man team to spend three weeks reviewing a contractor's procurement system, now two individuals must conduct the review in two weeks. While the impact of these changes have yet to be fully determined, concern was expressed as to the possibility of inadequate coverage of firms now below the new threshold, the fact that three year reviews provide an even less realistic appraisal of contractor's procurement systems, and that reduction in personnel and time allotted for CPSR's will result in inadequate determinations as to the true effectiveness of procurement systems.

With these findings, more confidence in the Navy and Air Force approaches may be warranted. However, DCAS personnel stated that it would be impossible for them to adopt Navy or Air Force methodologies, even if desired, due to the number of contractors under their cognizance and the scarcity of personnel resources to devote to subcontract management functions. The Navy and Air Force approaches are not without problems either. While they apparently can overcome the potential problems regarding consent to subcontracts and CPSR, through continuous real time surveillance of subcontractor efforts, they also call for greater involvement and more surveillance of the prime contractor's management of subcontractors.

Prime contractors often expressed resentment at this degree of involvement, particularly when Government personnel overstep their bounds and fail to distinguish between monitoring and managing subcontractor efforts. Prime contractors further contend that if they are being paid to obtain and manage subcontracts they should be free to do so with a minimum of Government intervention. It should also be noted that some Government contract administration personnel feel the same way. In fact, one contract administrator stated, that in his opinion, the degree and willingness of Government personnel to get involved has lead to prime contractors requesting Government assistance with regard to subcontracting functions that are clearly the responsibility of the prime contractor. For example, under P.L. 87-653, it is the contractor's responsibility to verify a subcontractor's cost and pricing data. If a subcontractor refuses to allow the prime to audit his accounting records, Government auditors will step in and perform this function. It has been alleged, however, that certain prime contractors may claim they have been denied access to a subcontractor's records when this isn't the case. This allows prime contractors to utilize Government auditors to perform tasks for which the prime is paid to conduct. While, admittedly, this may be an isolated complaint, it does underscore the potential for problems and controversy presently created by indirect Government relations and involvement regarding subcontractors.

In summary, controversy is definitely present, both within industry and Government, as to how best to manage subcontractors, as well as incentivize prime contractors to do better in this regard. What tools and organizational structure affords the most effective and efficient management; and how much involvement, if any, on the part of the Government is really necessary? The questions and uncertainty presented here are directly related to present Government policy regarding the handling of subcontracting, present Government-prime contractor-subcontractor relationships, and Government insistence on placing the responsibility for subcontract management with prime contractors while simultaneously reserving the right to get involved whenever and wherever it is deemed appropriate. It appears this controversy may only be resolved through a change in policy and relationships or the creation of total confidence, on the part of Government acquisition officials, with regard to a prime contractor's ability to effectively place itself in the Government's position with respect to interests and requirements when subcontracting. Neither alternative appears likely, as the former may shift unacceptable risk to the Government while the latter represents utopia. Some degree of Government involvement with respect to subcontractor efforts and management appears inevitable.

C. PRIME CONTRACTOR PROBLEMS

As was the case with high ranking Government acquisition officials, prime contractor interviewees were basically

satisfied with Government-prime contractor-subcontractor relationships. Most prime contractor personnel interviewed agreed that the Government had the right to monitor a contractor's efforts regarding subcontractor management and indicated they could understand why the Government might feel compelled to perform monitoring and surveillance functions to a certain degree, however, they did not see the need for detailed involvement. Prime contractors contend it behooves them to effectively manage subcontractors, without Government intervention, as they realize full well that failure on the part of critical subcontractors will be detrimental to their goals as well as to the ultimate customer. Through the practice of established fundamental Government procurement procedures, prime contractors feel they can effectively foster their own goals and objectives as well, and thereby help assure a quality product is delivered on time and for a reasonable sum of money. This rationale appears self-motivating to them and they see little need for Government efforts to increase incentives with regard to enhanced subcontract management. This is quite a different view then that expressed by Air Force personnel who claim their subcontract management program is really responsible for enhanced subcontract management efforts on the part of prime contractors.

Prime contractors also favor Government programs such as the consent to subcontract requirement and the CPSR program. Interviewees often stated that they would rather the Government

review the provisions of their subcontracts prior to award as opposed to having the Government express doubts and reservations with subcontract arrangements after award when it was much more difficult to effect changes. With regard to CPSR, prime contractors viewed it as an opportunity to improve their procurement systems and enhance their operation through the use of Government procurement experts. Prime contractors were also queried as to whether Government regulations and requirements, stemming from direct Government-prime contractor relations as well as those subsequently included in prime contractor-subcontractor relations, were not overly burdensome and costly. While there was no question that complying with the multitude of Government rules and regulations was indeed viewed as burdensome and costly, large prime contractors doing business with the Government appeared very complacent and resigned to these encumberances as a fact of life. Many expressed the view that if a great deal of your business was dependent on Government contracts what choice did you have. Furthermore, additional costs caused by Government regulations and requirements were merely included in company proposals and passed along to the buyer.

With regard to problems created by Government-prime contractor-subcontractor relations, the few that were expressed, were not with the acquisition system itself but with Government personnel and their interpretations as to how the system was designed to function. For example, one prime contractor's representative stated his organization was perfectly

happy to have Government personnel monitor their management of subcontracts, attend subcontractor meetings, make suggestions and assist with the solving of subcontractor problems. However, when monitoring by Government personnel became management and recommendations became directives, they became upset because they understood it was the prime contractor's responsibility to manage subcontractors; not Government's. Other prime contractors expressed similar views. There appeared to be a rather ill-defined line between Government suggestions and directives with regard to subcontractors which, when crossed by Government personnel, caused varying degrees of difficulty and animosity. One prime contractor related how his PCO reviewed a large number of his subcontract negotiation files and actually began to tell him how to negotiate, and what to offer prospective subcontractors. The prime contractor felt he was in a better position to ascertain whether a subcontractor's price was fair and reasonable, in light of current market and industry conditions, and highly resented Government personnel acting as though the prime contractor was incapable of performing the job properly.

While other problems were mentioned by various prime contractors, they appeared to be isolated incidents and minor in nature. Only the perception by contractors of Government personnel overstepping their authority was considered a significant problem which may negatively impact on future relations and be detrimental to the Federal acquisition process.

D. SUBCONTRACTOR PROBLEMS

Although Government representatives and prime contractors interviewed report their operations relatively devoid of problems in the Government - prime contractor - subcontractor relationship, the same cannot be said by the subcontractor in this scenario. Subcontractors appear to face problems with regard to their relations with both prime contractors and the Government.

As to subcontractor problems with prime contractors, Study Group Eight of the COGP outlined major areas of concern in its 1972 report [6; p. 350].

> In a negotation sense, subcontractors face particularly challenging problems. For example, prime contractors have objected, with considerable justification, to variances they find in working with different elements of the Government. These are minor as compared to the variables with which a subcontractor is confronted in terms of dealing with many major firms -- and the subcontractor does not have the depth of staff to apply to the complexities. The problems here are compounded by a general tendency on the part of prime contractors to pass down more risk and fewer benefits than they received from the Government. Subcontractors may not only lack awareness and understanding, as previously noted, but in addition may consider themselves handicapped by one additional factor -- monopsony. Factually, the prime contractor in many cases is as much of a monopsonist as the Government. Upon receipt of a major systems contract, the prime contractor may well be "the only game in town;" and the prime contractor looms as large and formidable to the prospective subcontractor as the Government once appeared to the prime contractor.

Furthermore, these problems appear to be intensified by Government actions and inactions as will be discussed shortly.

Subcontractor problems with the Government appear to originate mainly from the fact that the lack of "privity" between the Government and subcontractors precludes direct legal recourse for subcontractors while present relationships allow direct Government action as to subcontractor efforts, as previously outlined in Chapter IV. Frank Reda in an article entitled "Subcontractors: Privity and Severin" stated: "Sometimes a subcontractor must feel like the invisible man. He is there but nobody sees him" [33; p. 365]. Frederick Sass Jr., a lawyer for the Navy Department in a speech before the Southwestern Legal Foundation found another way to describe the problems of subcontractors. Sass, alluding to a cartoonist with the New Yorker Magazine who never uses words but draws people and animals and lines to symbolize his message stated [35]:

> They're not always comprehensible, but there is one I'm sure I understood. It is a drawing of a rather hatchet-faced man, with a line drawn above him from his forehead, a line which loops, whirls, zigzags, twists, forms confused shapes and angles, and loops back on itself a hundred times. The little hatchet-faced man is obviously befuddled. Plainly, he is thinking about the problems of subcontracting.

Problems of subcontractors do indeed appear to be numerous but identifying and dealing with them may help enhance the stability and productivity of the Federal acquisition process. The final statements of Study Group Eight, regarding subcontractor feelings with regard to their problems, and the necessity for maintaining a viable subcontractor base underscores the potential seriousness of the situation [6, p. 351].

> Subcontractors, on the other hand, generally are far less content with the present mode. They are not convinced that subcontracting for the Government, with its unique complexities and demands, represents an attractive long range market -- particularly in view of the remote, and perhaps even indifferent, treatment accorded by the Government.
>
> The Study Group believes that a dynamic, healthy family of subcontractors is essential to the Government procurement process. To the extent that the present system mitigates against this, remedies are indicated.

While it is not feasible to address every single subcontractor problem uncovered during the course of this effort, it is felt that the root of many subcontractor problems originate from two key areas: prime contractor "overreach" and the lack of "privity" between the Government and subcontractors which precludes direct remedial action against the Government when warranted. These two areas will be discussed separately.

1. Overreach

Prime contractor "overreach" is a term used to describe an alleged general tendency on the part of prime contractors to attempt to pass down more risk and fewer benefits to subcontractors then received by the prime contractor from the Government. It also refers to discriminatory and unequitable treatment by prime contractors with respect to offerors attempting to win subcontractor awards. This allows prime contractors to diffuse and mitigate a certain amount of their contractual risk as received from the Government and reduce their chances of poor and unsatisfactory performance.

Research indicates that the following are examples of how prime contractors may treat subcontractors unfairly and shift risks via "overreach."

1. A prime may underbid a contract deliberately and then make up the difference by driving an overly hard bargain with subcontractors who need the work.

2. Prime contractors may receive a cost-type contract from the Government but pass on a FFP contract to subcontractors when the nature of work and risks involved may be more conducive to a cost-type instrument.

3. Primes may discriminate against certain subcontractors by allowing other subcontractors to submit late proposals without offering the extra time to all offerors.

4. Prime contractors may engage in auction techniques by leaking to subcontractors the price which must be met to receive the award.

5. Prime contractors often change, alter, expand or restrict those terms and conditions passed on to subcontractors so as to push risk downward or often obtain a better position with subcontractors regarding duties and responsibilities between the parties.

It should be noted that the Government, while claiming it is not concerned with terms and conditions between prime contractors and subcontractors, except for ensuring that prime contractors achieve those Government rights contained in mandatory flow-down clauses, may contribute and allow "overreach" to occur, at least inadvertently. It appears that the Government has been less than explicit regarding the wording of mandatory flow-down provisions. While in some cases the Government directs that clauses be incorporated exactly as written, such as Notice and Assistance Regarding

Patent and Copyright Infringement, Contract Work House Standards Act, and Overtime Compensation, in the majority of cases the Government only requires that the substance of certain provisions be incorporated into subcontracts. This allows prime contractors the freedom to change and alter clauses to their advantage as long as the substance of the clause is retained and serves to protect or achieve Government rights. The addition of a phrase or the deletion of one, however, may drastically change the meaning of a clause. For example, in those instances where the Government requires a prime contractor to secure a right from a subcontractor it may be possible for the contractor to add the words "and contractor" after the word "Government" thereby obtaining for the prime contractor rights achieved for the Government. This might allow prime contractors access to subcontractor records and data or achieve patent license rights, for example, when the original intent of the Government was only to have the prime contractor obtain these rights for the Government alone. Lack of explicit wording as to mandatory flow-down clauses tends to open the door for prime contractors in this regard. Unless the subcontractor is sophisticated enough to realize the prime contractor is taking advantage of the situation and has enough leverage to change contract wording, he may find himself legally obligated to conform to contractual provisions detrimental to his organization or which significantly increase his risks.

Similar examples of "overreach" occur with regard to clauses that are not subjected to flow-down by requirement of the Government but which are included in subcontracts to protect the prime contractor. Not only do prime contractors protect themselves but often protection consists of altering clauses to their advantage, at times explaining to subcontractors that the clause is required by the Government, when in fact no such requirement exists. The Changes Clause provides a classic example. While few if any subcontractors would probably argue with the legitimacy of a prime contractor including a changes clause identical to that used by the Government, research has found that prime contractors often expand the changes clause to provide them the unilateral right to change quantity and delivery dates in addition to the normal provisions of the Government changes clause.

Warranty and option provisions included in any prime contract must also be flowed down to subcontractors to allow prime contractors to fulfill Government obligations imposed by those provisions. However, prime contractors often extend warranty provisions with subcontractors and may change option time periods, quantities, and prices in an effort to obtain a better deal from subcontractors.

Finally, the Termination for Convenience Clause offers still another example of "overreach." Because the Government may terminate a prime contract for convenience, prime contractors must protect themselves by requiring the same provisions with their subcontractors. However, the clause recommended

by the Government in DAR [10; 8-706] may not be in the best interests of subcontractors. First, it allows prime contractors to terminate subcontracts even though the Government has not terminated the prime contract. In effect, prime contractors can terminate subcontracts for whatever reason they choose. While this may appear fair and equitable one must realize that under this clause a prime contractor may terminate his subcontract for any reason without having to pay anticipatory profit or damages. This is not the case involving terminations under the UCC. Second, the clause provides a prime contractor access to subcontractor accounting records so that termination settlement may be achieved. Third, subcontractors are given six months to prepare their claims, while prime contractors receive twelve months from the Government. Finally, even though this clause is strongly recommended to prime contractors for use in subcontracts, it is not mandatory. However, subcontractors interviewed alleged that prime contractors have upon occasion indicated it is a required Government clause.

While additional examples constituting prime contractor "overreach" could be presented, the above examples typify the existence of "overreach." Every Government and subcontractor representative interviewed conceded that "overreach" in fact was a way of life for many subcontractors. Various articles in the literature, as well as the COGP report, also indicate the practice exists. The more pertinent questions become whether or not "overreach" is detrimental to subcontractors

in general, and the Federal acquisition process in particular, and whether the Government can or should get involved in an attempt to alleviate the present situation.

In an attempt to ascertain the effect of prime contractor overreach, for the purposes of this research effort, subcontractors were divided into three categoriys: "A", "B", and "C". "A" category companies were large major defense concerns who performed as both prime contractors as well as subcontractors when involved in Government acquisition. "B" category firms were medium-sized companies who performed as either small prime contractors or subcontractors but were primarily thought of as key subcontractors. "C" category firms were small business firms with less than one thousand employees.

Interviewees indicated that prime contractor "overreach" did not impact significantly on large category "A" firms. While "overreach" was attempted on occasion, category "A" firms were too powerful and possessed too much leverage of their own to submit to any terms and conditions which might place inordinate risk upon them. Category "A" firms would more quickly refuse contracts if the risks were too great, as they had more avenues and opportunities for additional business than smaller firms. Category "A" firms were used to constantly dealing with the Government, were thoroughly familiar with Government clauses and requirements and could easily detect whether prime contractors were merely protecting Government interests or attempting to inequitably pass risks

down the line through proposed terms and conditions. Furthermore, category "A" company personnel indicated that their prime contractors were far less likely to attempt "overreach" with them because next month their own company may be a prime contractor on a different award and therefore be in a position to retaliate against those who had previously attempted "overreach."

Although the research was structured to distinguish between category "B" and "C" firms, they provided similar views with respect to "overreach" and are therefore discussed together. Category "B" and "C" firms interviewed definitely believed major prime contractors regularly attempted "overreach." Furthermore, each representative related individual examples of how prime contractors passed down riskier contracts than received from the Government and generally drove tougher bargains with their companies in negotiations than the Government drove when their companies attempted to win Government prime contract awards. Naturally, each firm interviewed stated they tried to counter those aspects of a proposed subcontract they felt detrimental to their interests but their ability to do so was dependent on their relative bargaining strength at the time of each individual subcontract. Subcontractor comments involving "overreach" included the following. First, the more competition achieved by prime contractors the more a subcontractor's bargaining position was weakened. The more subcontractors available to bid the more likely the prime contractor could find a company hungry enough to accept risks

considered too great by other offerors. Many subcontractors interviewed stated this caused them to strive to achieve technolgocial superiority, mainly through company funded research and development, in an attempt to become sole source with regard to their particular product line so as to achieve their goals and avoid "overreach" at the negotiation table. Second, the more dependent a subcontractor's business was on large Government prime contracts the more effective "overreach" became. Most subcontractors therefore attempted to diversify their efforts between commercial and Government business so as to gain some ability to refuse subcontracts with unacceptable risks, terms, and conditions. Third, some subcontractors attempted to counteract the altering of terms and conditions by negotiating forward agreements, as to standard terms and conditions with major firms, which would apply to all subcontracts thereafter. This avoided the tendency on the part of subcontractors to submit to more risk than was prudent due to time pressures often experienced when subcontracts had to be hammered out quickly so as not to unduly delay commencement of work. While the theory appears excellent, the disadvantage of forward agreements is that they often take years to negotiate and each prime contractor having his own terms and conditions must be dealt with separately. Fourth, with the possible exception of one sole source subcontractor, every category "B" and "C" firm interviewed stated that they had been forced to accept contracts where risks were higher than they would have liked and on occasion they had lost money

on such contracts. Fortunately, they had made money on more contracts than they had lost and were still in business but one firm stated that prime contractor "overreach" was one reason his company had reduced Government business from about 65% to 35% of his total business. Fifth, subcontractors emphatically stated that to effectively function as a subcontractor on Government projects and attempt to obtain fair and equitable contracts from prime contractors, a contract administrator, familiar with Government rules, regulations, and relationships between the involved parties was a must. Many companies stated that prior to creating the contract administrator position their problems with prime contractors were compounded by a lack of knowledge regarding mandatory vice non-mandatory Government flow-down provisions and the specific wording and meaning of Government clauses, regulations, and requirements. This left them relatively defenseless to counter or ever recognize the potential pitfalls of prime contractor terms and conditions. It was also stated that this situation was still felt to exist today for those smaller subcontractors who lack the resources necessary to acquire competent contract administrators, accountants and lawyers necessary to protect their interests when dealing with Government rules and regulations as well as giant defense contractors.

Finally, most subcontractors stated that if prime contractor requirements, deemed less than equitable by subcontractors, could not be altered, an attempt was made to cover

any additional perceived risk through contingency pricing designed to offset the occurrence of those risks. For example, if a prime contractor extended the subcontractor warranty period over and above that required of the prime contractor by the Government, the subcontractor increased his prices to cover the extra warranty period. Similarly, if a prime contractor tightened the specifications, with regard to components, to provide an extra margin of safety with which to meet Government requirements, the increased likelihood of a subcontractor being unable to achieve these tighter specifications were reflected in the contract price.

With regard to suggestions for altering present relationships, those subcontractors less able to combat "overreach" were receptive to minor changes designed to limit the practice. Such changes could include increased Government intervention and surveillance over prime contractors or establishment of a Government set of standard terms and conditions for subcontractors which would achieve the objectives and protect the interests of the Government while limiting a prime contractor's present ability to alter many current DAR clauses for his own benefit. Mr. Norm Singer, Vice President of Federal Publications recently advocated such a proposal [41; p. 70-76]. Under his proposal, the Government would develop a standard set of terms and conditions to be used by the prime contractor in the subcontract which would foster and protect Government requirements as well as include all provisions necessary for a prime contractor to fulfill his

Government obligations. For example, all mandatory flow-down provisions would be included as well as self protection clauses such as the Changes Clause. However, the Changes Clause would provide the prime contractor only those rights with subcontractors as he currently enjoys with the Government and nothing more. The same rationale would prevail for other self protection clauses contained in the standard set of terms and conditions. Prime contractors would be free to demand other considerations from subcontractors and obtain additional protection, but these provisions would be listed separately from the standard terms and conditions. Furthermore, subcontractors would be requested to submit two bids on each proposal. One based only on the requirements and risks applied by the standard set of terms and conditions and the other priced to include any additional requirements levied by the prime contractor for his own benefit. This procedure appears to have many benefits. First, subcontractors would save an inordinate amount of time by not having to examine each clause to see how the prime contractor's demands differ from Government requirements. Second, it will be more difficult for prime contractors to disguise risk shifts because prime contractor requirements, above and beyond those necessary for the Government, will be clearly delineated and can be worked out at the negotiation table. This will help the smaller subcontractor who may not have the resources of an experienced contract administrator or lawyer. Finally, Government acquisition officials

will be able to see the costs of additional prime contractor requirements placed on subcontractors and will be better able to deny costs which provide no additional benefits for the Government.

As might be expected, subcontractors with ample leverage, market dominance, or in a sole source position saw no need for further Government involvement nor intervention since they were able to effectively negotiate terms and conditions with prime contractors which they perceived as fair and equitable to both parties.

Prime contractors envisioned this entire exercise as fruitless and a waste of time as they contend "overreach" does not occur, at least within their organization. Even when presented their own set of subcontractor terms and conditions where the changes clause, for example, had been expanded to cover quantities, their response was that they had never exercised that right.

The second pertinent question, proposed earlier, asked what can or should the Government do to rectify unfair practices or inequitable risks forced on subcontractors by prime contractors. With respect to what can the Government do, interviewees answered that the Government can basically do anything it wants. Past history certainly demonstrates the Government has not hesitated to interfere with prime contractor - subcontractor relationships when Government interests were at stake or Government requirements, with respect to subcontractor efforts, were necessary. However, the concensus

of Government acquisition interviewees, with regard to what should be done concerning "overreach," was virtually unanimous - nothing! First, Government acquisition officials did not perceive the problem of "overreach" as being detrimental to the subcontracting base and therefore the Federal acquisition process. They contended that they knew of no prime contractors experiencing difficulty in obtaining an ample number of subcontracts for Government programs, they had received few complaints from subcontractors as to prime contractor abuse, and they did not perceive a mass exodus of subcontractors from the Government acquisition arena due to unfair distribution of risk, inequitable procurement practices, or detrimental terms and conditions. Second, Government acquisition officials stated the Government should not interfere where they had no "privity of contract." The sharing of risks and the determination of terms and conditions was strictly between the parties involved and any Government intervention would result in additional outcries from private industry. Third, it was felt that current procedures, such as consent to subcontracts and CPSR, along with surveillance of prime contractor management of subcontractors, was sufficient to detect any procurement procedures on the part of prime contractors that may be detrimental to subcontractors and subsequently to the Federal acquisition process. Finally, some Government personnel felt that the tougher prime contractors dealt with subcontractors the better, since costs would decrease for Government weapons programs.

While these views were virtually unanimous, one or two minority views were also expressed. Certain interviewees, while expressing that relations between prime contractors and subcontractors should be of no concern to the Government, alluded to possible indirect consequences arising for the Federal acquisition process due to "overreach". First, prime contractor procurement practices which favor one subcontractor over another may result in failure to select the best subcontractor when all criteria for award are considered. Second, as alluded to by Mr. Singer, "overreach" wastes contractor time and effort which might be better spent on performance and adds additional cost for benefits primarily received by prime contractors; not the Government. Third, prime contractor "overreach", which forces a subcontractor to accept risks and provisions he later learns he cannot handle or acomplish, may result in subcontractor failure. Such failure could result in program delays, cost growth, and administrative problems for all concerned. Fourth, the forcing of more risk than that assumed to be fair and equitable may create animosity between two crucial players within the Government acquisition process which may hinder the cooperative spirit and sense of teamwork necessary for successful program accomplishment. Finally, the Government attempts to determine what is fair and equitable with regard to the sharing of risks with prime contractors during the negotiating phase. The fact that a prime contractor further dilutes his risks with subcontractors, over which the Government does not enjoy a direct legal relationship, may

result in more risks accruing to the Government than initially agreed upon, particularly if a prime contractor miscalculates the degree of risk a subcontractor can or is willing to assume.

It should also be noted that precedent has been established for Government concern and possible intervention with regard to "overreach" in the past. The DOD acquisition officials stated that in the 1973-1974 time period many prime contractors had obtained production options from most major subcontractors with prices based on a 3% to 4% inflation rate. During this period, inflation jumped as high as 10% to 12%. Many subcontractors voiced concern over the fact that prime contractors would not relax their obligation or renegotiate new option provisions. Many subcontractors stated that forcing them to honor such options would cause serious financial difficulties and possibly force them out of business. The DOD informally discussed this matter with several prime contractors and eventually most, if not all, subcontractors were able to renegotiate their options. In 1978, DOD tasked the Logistics Management Institute (LMI) to conduct a study designed to assess the affect of subcontracting precepts and practices held by prime contractors on major systems acquisition and to recommend requirements DOD could adopt in governing the application of prime contract provisions to associated subcontractors [25]. While this study concluded that no major problems existed in this area, and no further Government intervention was deemed necessary, studies such as this, along with Government actions of the mid-seventies, serves to indicate some

degree of concern regarding "overreach". Some Government acquisition officials apparently do realize that unfair and inequitable practices between prime contractors and subcontractors have at least the potential for negatively effecting the Federal acquisition process and have acted accordingly.

2. Subcontractor Remedies

Another major area worthy of analysis, with regard to Government - prime contractor - subcontractor relationships, involves the nature and adequacy of subcontractor remedies with respect to Government actions or inactions. DOD prime contractors, operating under "privity of contract" with the Government, are afforded both administrative and judicial remedies if (1) it is felt Government actions are unfair or inequitable, (2) the Government has failed to fulfill contractual responsibilities, or (3) Government actions or inactions result in increased costs not anticipated during the initial negotiations of the contract. For example, under the Tucker Act of 1887, the Government as a sovereign, has agreed to be sued for breach of contract by those with whom an express or implied contract has been established [29; p. 747]. Furthermore, the Comptroller General has statutory authority to settle and adjust claims against the United States, but again only with those enjoying "privity of contract" with the Government [29, p. 748]. Finally, prime contractors are able to utilize the Disputes Clause which provides that all questions of

fact arising out of the contract are to be decided by the Contracting Officer, subject to the Contractor's right of appeal. The contractor may appeal decisions of the Contracting Officer either to the Armed Services Board of Contract Appeals (ASBCA) or the Federal Court system. Some of the more common situations in which this benefit serves to protect the rights and interests of the prime contractor include, but are not limited to, the following [32, p. K-1-24.6]:

1. Changes Clause; equitable adjustments;
2. Inspection Clause, acceptance of items and reduced prices for those items which do not meet specifications;
3. Default Clause, whether or not the contractor is in default or there is excusable delay;
4. Termination Clause, amount of settlement and the many complex problems regarding the disposal of termination inventory;
5. Government-Furnished Property Clause, equitable adjustments for failure to deliver acceptable property in a timely fashion or for decreases in the amount of the property furnished;
6. Amount of price revision under redetermination and incentive type contracts;
7. Amount of escalation under an escalation clause for material and labor.
8. Allowable Cost Fixed Fee and Payment Article;
9. Excusable Delays.

When these clauses are used in the prime contract, they either specifically provide for a contractor's right of appeal or his right of appeal is established by the Disputes clause which applies to all questions of fact arising from the contract. As a further illustration of this provision, consider the Changes Clause which allows the Government to make certain unilateral changes to the

contract. The Government and prime contractor attempt to reach agreement as to an equitable adjustment for performing the change. If agreement is possible, the Contracting Officer may unilaterally decide what constitutes an equitable adjustment under the Disputes Clause. If the prime contractor is still not satisfied, he may appeal the decision to either the ASBCA or Federal Court system.

With regard to subcontractors, Government - prime contractor - subcontractor relations preclude the establishment of "privity of contract" between the Government and subcontractors as outlined in Chapter IV. The lack of "privity," therefore, effectively bars subcontractors from bringing suit against the Government in either District Courts or the Court of Claims or before the Comptroller General. Furthermore, subcontractors are denied the benefit of the Disputes Clause as it is designed for the benefit of prime contractors alone, and the ASBCA has no authority to consider a subcontractor's direct appeal unless such authority is expressly provided for in the prime or subcontract [32; p. K-126]. The standard Disputes Clause contains no such provision and, within DOD, contracting officers are specifically prohibited from approving any subcontract disputes clause which grants a subcontractor direct right to obtain a decision from the Contracting Officer or ASBCA [10; 23-203]. Therefore, when clauses are flowed down to subcontractors, either as mandatory or

self-protection clauses, any which provide for specific appeal rights, or to which the standard Disputes Clause is applicable under prime contracts, are altered to delete the appeal provisions. While prime contractors may still alter, change, or make determinations with regard to subcontractors, any disputes or disagreements which arise are strictly between the prime contractor and subcontractor, even though Government action or inaction may have initiated the entire chain of events.

With the avenues of direct relief as a result of Government action or inaction effectively blocked, subcontractors have been forced to find other means of obtaining relief from the Government. The primary recourse available to subcontractors has been to persuade prime contractors to bring suit on their behalf or seek the prime contractor's permission to bring suit in his name. Any costs recovered by the prime contractor would then be provided to the subcontractor. According to Professor Whelan, this procedure, referred to as the "good shepherd" approach, has been given general approval by the Government and ASBCA for many years [51; p. 6.88]. This approach may also be used in cases where a prime contractor appeals on behalf of subcontractor under the Disputes Clause contained in the prime contractor's contract with the Government. Instead of seeking relief from the Government, a subcontractor may also sue the prime contractor under their legal arrangement

and the UCC but this results in a subcontractor sacrificing the speed and informality of administrative proceedings, and may be inequitable to the prime contractor since the Government may really be the party at fault. This would be particularly true in those instances where a subcontractor was awarded more money from the prime contractor through arbitration or the judicial process than the prime contractor was able to receive from the Government, in which case the prime would be forced to make up the difference. Discussions with subcontractors by this researcher also indicated a reluctance to bring suit against prime contractors because the cost of litigation often exceeded the settlement and suits against prime contractors may result in reduced chances for future subcontracts from that particular prime contractor.

If legal proceedings by subcontractors against prime contractors for Government acts or omissions appear unappealing, at least to some subcontractors, the "good shepherd" appraoch also has its drawbacks. First, a prime contractor may refuse to act as a "good shepherd." As an example, in a majority of cost-type subcontracts, prime contractors insist on a provision that in the event of a subcontractor claim, a subcontractor will only receive that amount of money which the Contracting Officer agrees to reimburse the prime contractor for his services [32; p. K-1-27]. With this type of provision, the prime contractor has little incentive or interest in processing

a subcontractor's appeal since the prime is legally entitled to simply take the money awarded by the Contracting Officer and provide it to the subcontractor. The prime contractor has lost nothing and the subcontractor has no further legal recourse. Second, any prime contractor who is reluctant to appeal on his own behalf, due possibly to fear of jeopardizing his chances for future awards or fear of earning the reputation of being difficult to get along with, is even less likely to allow his name to be used by a subcontractor in forwarding an indirect appeal. Third, a prime contractor may consider the size of a subcontractor's claim relatively small in relation to the total prime contract and not worth the effort even though the size of the claim may be considered substantial and very important to the subcontractor. Fourth, a prime contractor may act without diligence so that its own position as a litigant is denied due to failure to comply with certain appeal provisions contained within the Disputes Clause. A classic example of this occurred in the Blount Brothers Case [4]. In this case the prime contractor, Blount Brothers Corp., received claims from two subcontractors for $35,000 for work performed relating to change orders. The subcontractors in this situation were bound by their relationship with the prime contractor to abide by the outcome of any resolution of disputes between the prime contractor and Government under the standard Disputes Clause. On

June 9, 1978, the Contracting Officer made a final decision to deny the claim of Blount Brothers on behalf of the subcontractors. It was not until July 18, 1978 that Blount Brothers appealed the Contracting Officer's decision. This appeal was declared untimely, as it exceeded the 30 days allotted to file an appeal, and was subsequently denied. However, on June 27, 1978 one of the subcontractors filed an appeal directly to the Contracting Officer. It too was denied since it was in the subcontractor's name, and without "privity of contract" between the subcontractor and the Government, the Appeals Board had no jurisdiction. Had the June 22nd letter emanated from Blount Brothers it would have been timely and the appeal considered. In this case, the subcontractors in question were left virtually helpless and $35,000 poorer. The provision within the subcontract forced them to comply with the Government's decision, while the prime contractor's lack of diligence precluded their indirect right of appeal and any hope of receiving their monies. While it is conceivable the subcontractors in this instance may have had grounds on which to sue the prime contractor for negligence, the point remains that subcontractors are often forced to rely on another party, who may not possess the same high degree of interest in achieving legal remedies, when attempting to seek justice and equitable treatment under Government contracts. Finally, and possibly the most severely limiting element

precluding subcontractor relief under the "Good Shepherd" approach, involves the so-called Severin Doctrine [37]. The Severin Doctrine originated from a case in which suit was brought against the Government by a prime contractor both for himself and a subcontractor as a result of Government delays. Within the subcontract was an exculpatory clause which stated the prime contractor would not be liable for any loss, damage, detention or delay caused by the owner - in this case the Government. The Court of Claims held that while the prime contractor was entitled to recover damages, the subcontractor could not because the prime contractor must show he had paid damages due a subcontractor or was liable for damages claimed by a subcontractor. In this case, the exculpatory clause released the prime contractor from any liability with respect to his subcontractor. The subcontractor could not appeal directly to the Government as he lacked "privity of contract" and was therefore left without a remedy. Under the Severin Doctrine, any prime contractor who brings suit on behalf of a subcontractor, or appeals a Contracting Officer's decision on behalf of a subcontractor under the Disputes Clause, must establish a basis for his suit against the Government. A prime contractor must be liable for damages to a subcontractor before he may appeal or bring suit on behalf of the injured subcontractor. Any exculpatory clause contained in the subcontract may block a prime contractor from seeking

remedies on behalf of a subcontractor even though the prime contractor is willing to advance such an action. Fortunately, the harshness of the Severin rule has been mitigated by subsequent Court of Claims decisions which, for example, have allowed a prime contractor to seek remedies on behalf of subcontractors when the subcontract is silent as to the ultimate liability of the prime contractor. In another instance, the Court of Claims examined an exculpatory clause in a subcontract and found it was designed to insulate the prime contractor only in those cases where Government acts or omissions caused damages not recoverable short of a breach of contract suit. The court found that the exculpatory clause did not apply to those situations where the prime contract itself specifically provides for compensation from Government acts or omissions, such as changes or delays. In this case, since the subcontractor's claims concerned areas where the Government specifically provided compensation for Government actions it was ruled the exculpatory clause and Severin rule did not bar a prime contractor from seeking remedies on behalf of an injured subcontractor. It should also be noted that the ASBCA has basically followed the lead of the Court of Claims when deciding whether the Severin Doctrine is applicable or not. Regardless of the subsequent mitigation of the initial Severin ruling, the real point is that even where a prime contractor agrees to seek remedies on behalf of a

subcontractor there is no guarantee that either the Federal Courts or ASBCA will have jurisdiction. Each subcontract must be looked at individually to see if exculpatory clauses may preclude appeals to Federal authorities. While a simple solution might be to advise subcontractors not to accept any type or form of exculpatory clause from prime contractors, this ability depends once again on relative bargaining strength when the subcontract is formulated. The key question becomes, should the ability of subcontractors to seek remedies for alleged damages be based upon their negotiating strength or should the privilege of redress of grievances be equitably afforded to all parties involved?

There is yet another interesting facet to the subject of subcontractor remedies. While many subcontractors resort to the "good shepherd" approach, as it is their only viable recourse, some interviewees stated that subcontractors may be able to take a more expedient approach - blackmail! Consider the following example. The Government directs a unilateral change which affects only the component being designed and developed by a subcontractor. The Government and prime contractor agree on an equitable adjustment but the subcontractor does not agree that the amount is equitable. The prime contractor refuses to appeal the Government's decision as a "good shepherd" for one of the reasons mentioned previously. The subcontractor feels a commercial suit is too expensive, time consuming, and not worth the effort. The subcontractor decides simply to stop

performing until agreement is reached. While this dispute is basically between the prime contractor and subcontractor, the Government also loses in this scenario. In stopping performance, the subcontractor may seriously impair meeting the delivery schedule, costs rise for the prime contractor which may ultimately be paid by the Government, and the entire benefit of harmonious relationships between contractors may be destroyed. Had there been a provision in the subcontract allowing the subcontractor some type of appeal route to the Government, along with a requirement to continue performance, as is the case with prime contractors, this situation may have been avoided. While it is recognized that the subcontractor risks legal action by the prime contractor, along with jeopardizing his chances for future awards, it was alleged during interviews that this practice continues to occur and that just the threat of such action may be a powerful weapon for subcontractors. Again, however, the ability of any subcontractor to successfully employ this tactic depends on negotiating strength and the relative importance of the subcontractor to the prime contractor's efforts. Perhpas the greatest revelation emanating from the alleged use of blackmail is the potential for disruption and chaos within the acquisition process when subcontractors opt, or are forced, to resort to such tactics due to the lack of any perceived viable alternatives and the

apparent lack of any contract provision requiring continued performance during the resolution of disputes.

In researching the problem of apparent inequities regarding subcontractor remedies it was often suggested by the literature that subcontractors be allowed direct appeal rights to Government authorities, the same as prime contractors currently receive.

In discussing the feasibility of direct subcontractor appeals, most Government acquisition officials expressed a variety of concerns regarding this procedure. Many felt any disputes raised by subcontractors should be handled entirely between the prime contractor and subcontractor. The prime contractor is paid to manage his subcontractors and the resolution of disputes falls within this management function. Other arguments included the lack of "privity" concept whereby subcontractors without "privity" have no judicial recourse against the Government and therefore no basis for appeal. While this is true regarding direct subcontractor suits against the Government for breach of contract, the wall of privity can be broken down in the area of administrative appeals under the Disputes Clause. As previously discussed, direct appeal by subcontractors may be allowed if a Contracting Officer is authorized to consent to a subcontract disputes clause which allows direct subcontractor appeals. While DOD regulations prevent consent in these situations, the Department of Energy (DOE) does

allow subcontractors direct appeal to their administrative appeal board. In this situation, a subcontractor obtains at least a certain degree of recourse from Government acts or omissions even if still precluded from directly suing the Government for breach of contract. Government officials also argued that granting subcontractors a direct right of appeal would place the Government in the position of an arbitrator in those disputes primarily between the prime contractor and subcontractors and that increased appeals would inundate the ASBCA with an unacceptable workload. On the other hand, a National Security Industrial Association (NSIA) workshop, conducted by NSIA legal and special tasks subcommittee, contends that such arguments fail to adequately draw a distinction between disputes that are primarily between the prime contractor and subcontractor and those that are, in theory between the prime and subcontractor, but that are actually between the Government and the subcontractor [28; p. 65]. The NSIA further suggested the following situations where Government actions may result in disputes actually between the Government and subcontractors, or at least impact on subcontractors as much if not more than the prime contractor, and therefore may lend themselves to the granting of an expansion of subcontractor remedies [28; p. 6]:

1. Subcontractor Defective Pricing Data Problems.
2. Disallowance of items of cost included in subcontractor's overhead and other loading rates.

3. Disallowances of costs on cost reimbursement subcontracts, or incentives on cost plus incentive fee subcontracts.
4. And generally, any situation in which the same issue exists between the Government and the prime contractor and between the prime contractor and the subcontractor.

As for overly burdening the ASBCA, while this possibility exists, any changes in present subcontractor remedies could be instituted on a trial basis so as to measure the increased workload, if any, prior to any final conclusive action. Finally, Government officials expressed concern that granting direct appeal rights to subcontractors may result in end runs by subcontractors to the Government without attempting to first settle with prime contractors. Furthermore, the possibility exists that both the Government and a prime contractor may settle a subcontractor's claim and the Government might then be called upon to reimburse the prime contractor for the payment of the same claim. One possible compromise, which appears to avoid some of the arguments against direct subcontractor appeals, involves a disputes clause already being used by certain prime contractors in their subcontracts. Under this clause, subcontractors, while not granted direct appeal rights, may indirectly appeal a Government decision when the same issue exists between the prime contractor and the subcontractor and

between the prime contractor and Government, and where the prime contractor chooses not to appeal the decision. In other words, the prime contractor is actually guaranteeing his role as a "good shepherd". Currently, in many subcontracts, while the prime contractor may appeal on behalf of a subcontractor, he is not legally or contractually obligated to do so. In addition, all parties accepting this clause would be bound by any decision emanating from the appellate process under the Government Disputes Clause. Furthermore, while the appeal is in process, performance would continue. A sample of this clause is contained in Appendix B.

Most prime contractors interviewed contended that they saw little need for any changes involving subcontractor remedies as they stood ready and willing to allow subcontractors to appeal to Government authorities under the "good shepherd" approach. However, when queried as to guaranteeing a subcontractor's right of appeal under the prime's name or under the prime contract, some expressed reservations that such a provision would limit a prime contractor's flexibility in handling disputes and disagreements involving its subcontractors.

Subcontractors had mixed emotions regarding this issue. While most agreed that the present situation can be inequitable for subcontractors, and that on occasion they have settled for less than what they considered an

optimal adjustment due to lack of alternative courses of action, subcontractors expressed concern for any remedy which excluded the prime contractors entirely. Subcontractors would prefer to let prime contractors settle disputes involving Government actions for them. However, in situations where the prime contractor refused to accept this role, most subcontractors did favor the right of appeal under the Disputes Clause. Not all subcontractors, however, favored a disputes clause in their contracts with prime contractors because it would contain the requirement to continue performance pending resolution of the conflict. This appears to lend credence to the practice, or at least the threat, of blackmail as a means of forcing prime contractors to provide adjustments more favorable to subcontractors. In those situations where disputes were solely between the prime contractor and a subcontractor, subcontractors, prime contractors, and government officials all felt the Government should not intervene, force arbitration on the parties, or otherwise dictate the method by which such disputes would be settled.

E. SUMMARY

In summary, problems and difficulties, seemingly inherent within Government - prime contractor - subcontractor relationships, have been identified and addressed. These problems, along with previously proposed solutions, appear extremely controversial and affect all three key participants.

The Government experiences difficulties in attempting to identify and implement the type and degree of involvement deemed appropriate to effectively monitor and control the efforts of subcontractors, with whom a legal basis for such action has not been established. Prime contractors, conversely, experience problems with their flexibility and management effectiveness when Government involvement exceeds what they deem to be reasonable and prudent. Subcontractors, on the other hand, must contend with prime contractor "overreach" when prime contractors are tasked with protecting the Government's interests and fostering Government procurement policy. Furthermore, while Government acts or omissions may impact dramatically on subcontractors, they may be denied basic appellate benefits due to their nebulous and ill defined position with respect to the Government, as opposed to the relative merits and validity of their grievances.

VI. CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS

1. The role and importance of subcontractors in the Federal acquisition process has changed dramatically over the past thirty to forty years, particularly in the field of weapons system acquisition. As technology has advanced and defense requirements continued to demand sophisticated, highly complex, and multi-purpose weapons systems, prime contractors can no longer hope to possess the multitude of skills, plant and equipment, and resources necessary to develop total weapons systems completely in house. Subcontractors have filled the void through specialization with respect to the design and development of critical components thereby enhancing their role and importance within the weapons acquisition process. Furthermore, as technology continues to advance and weapons systems become increasingly complicated this trend appears likely to continue.

2. The proper selection, performance, and management of major critical subcontractors has a definite impact on the success or failure of a major weapons system and therefore on the Federal acquisition process itself. As subcontractors assume an ever increasingly important role in the design, development, and production of key weapons system components their inability to perform, or substandard

performance, due to lack of facilities and capabilities, poor management of subcontractor efforts, or difficulties in successfully integrating complex components may result in program delays, cost growth, and substandard products ultimately delivered to the Government.

3. The Government's present policy of using an integrating weapons system contractor who, at least in theory, is charged with the responsibility for subcontract selection, performance and management and who assumes the risks of successful component integration, is basically sound and logical. Given the sheer numbers of subcontractors who participate in the design and development of today's weapon systems, the Government simply does not possess the resources to effectively establish, maintain and monitor contractual relations with each or coordinate the technologically complex process of integrating all components into an effectively functioning final product. The only viable recourse is to utilize and pay prime contractors to assume these functions with the Government monitoring the actions of the prime contractor to ensure Government interests are protected and Government acquisition objectives effectively fostered. Additionally, this method places the risk of poor or unacceptable subcontractor performance on the prime contractor, as opposed to the Government, as would be the case if the Government contracted directly with subcontractors for major weapon system components.

4. While present Government policy regarding the handling of subcontractors is basically sound and logical, the Government, in attempting to protect and foster its interests, has effectively created a complicated series of relationships involving both prime contractors and subcontractors. This has in turn resulted in a great deal of Government control over the selection, performance and management of subcontractors even though no direct contractual authority for such rights exists. Through the use of mandatory flow-down clauses contained in the prime contract, the Government forces subcontractors to abide by a variety of Government rules, regulations and procedures if they wish to participate in Government funded programs. Furthermore, by placing contractual obligations on prime contractors, which can only be guaranteed if equally applicable to subcontractors, the Government forces prime contractors to include self-protection clauses in subcontracts which further advance Government rights and requirements with regard to subcontractors.

5. In establishing Government - prime contractor - subcontractor relationships the Government has created an apparent one way street with regard to subcontractors. The Government has found numerous ways to apply Government rights and requirements to subcontractors without establishing a direct legal relationship. However, the lack of such a relationship - "privity of contract" - precludes subcontractors

from achieving direct legal remedies against the Government when Government acts or omissions impact directly on subcontractors. Subcontractor alternatives consist of either a commercial suit against the prime contractor or asking the prime contractor to appeal to Government authorities on their behalf. The former alternative is usually not selected since the time and expense of a commercial suit often fails to justify the judgment and may preclude further awards. The latter alternative will work only if the prime contractor consents to such an appeal and Federal judicial and administrative bodies conclude they have jurisdiction under the Severin Doctrine.

6. Prime contractors, in following Government requirements to flow down clauses designed to protect Government interest and in developing clauses which limit their own liability, have been accused of what may be termed prime contractor "overreach." "Overreach" can best be described as the process whereby prime contractors do not always follow prescribed Government procurement practices in the selection of subcontractors as well as attempting to pass more risks and fewer benefits to lower-tier contractors. The Government appears to inadvertentaly contribute to this scenario by its failure to prescribe to prime contractors a standard set of terms and conditions which it specifically desires within any given subcontract. This allows prime contractors the latitude of altering various clauses to

their benefit, and to the detriment of subcontractors, while still fulfilling Government requirements.

7. Current Government acquisition tools and procedures designed to ensure prime contractors follow prescribed procurement procedures in the evaluation and selection of subcontractors, such as the requirement for Contracting Officers to consent to certain subcontracts and CPSR's, may not be as effective as originally thought or envisioned. Research interviews indicate that the consent process may be merely a rubber stamp procedure in some cases and in other cases was not conducted in the in-depth manner prescribed by Government acquisition regulations. It was further contended that the effectiveness of contractor procurement system reviews have been diminished by personnel shortages within Contract Administration Offices resulting in fewer personnel devoting less time to CPSR's and less thorough and accurate evaluations of a prime contractor's procurement system and practices. Furthermore, the raising of the dollar threshold of Government contracts, above which CPSR's are conducted, has resulted in fewer firms being subject to the review and the more opportunity for undesirable and inequitable procurement practices.

8. While the effects of prime contractor "overreach" appear unfair and inequitable, at least for certain subcontractors, the long term effects of this practice on the entire subcontractor base and Federal acquisition process is uncertain at best. Subcontractors admit they have lost

money due to acceptance of greater risks than deemed appropriate. Personal interviews and the COGP report indicate subcontractor unhappiness with the current state of affairs. There does exist a tendency for subcontractors to mitigate Government risks through diversification to commercial ventures, which serves to reduce capacity for Government projects. However, Government and prime contractor personnel perceive no shortages of subcontractors willing to participate in Government projects and appear unconcerned as to subcontractor problems. What does appear certain, however, is that unfair and inequitable treatment of subcontractors, inadequate assessment of subcontractor risks and the rapidly changing economic environment has the potential to negatively effect the subcontractor as previously evidenced during the 1973-1974 inflationary period. Therefore, actions designed to mitigate current inequities and better monitor the practices of "overreach" to prevent future problems appear prudent, farsighted, and appropriate.

9. While Government officials and prime contractors have basically expressed satisfaction with Government - prime contractor - subcontractor relations, problems exist for these principals as well as for subcontractors. The Government, in its attempts to have few if any dealings with subcontractors, so as not to inadvertently shift risks from prime contractors, is faced with a dilemma. The Government must walk a tightrope between allowing prime contractors

the freedom and flexibility necessary to effectively guide and control subcontractors, while at the same time, attempt to monitor and incentivize prime contractor and subcontractor efforts to ensure Government interests are fostered and public funds judiciously expended. While some degree of Government involvement in this regard appears inevitable, controversy surrounds the question of how much involvement and in what form, is most effective, efficient and beneficial to all parties concerned. The situation is further complicated by a lack of DOD-wide policy and guidance as to the degree of involvement, the tools best suited for the task, and the organizational structure desired. This has resulted in a fragmented and divergent series of approaches to the problem by individual DOD components and CAO's.

Prime contractors also experience problems with present relationships when Government personnel, attempting to monitor the prime -subcontractor relationship, exceed their authority and actually attempt to dictate the prime contractor's management of a subcontractor, or worse yet, attempt to directly manage a subcontractor. Not only do such actions tend to relieve prime contractors of the risks of subcontracting, so zealously avoided by the Government, but serves to create adversity and ill-will between industry and Government which further inhibits the Federal acquisition process.

B. RECOMMENDATIONS

While it does not appear that problems inherent with Government - prime contractor - subcontractor relationships warrant revolutionary changes to the acquisition process itself, the following recommendations are offered in hopes of further enhancing the effectiveness of Government - prime contractor - subcontractor relationships, and their impact on the Federal acquisition process, as well as precluding potentially deleterious problems in future weapons systems acquisition.

1. Continued emphasis should be placed on award fee type contracts, particularly in the early stages of weapons design and development, as a means of incentivizing prime contractors to foster and protect Government interests regarding subcontractors and to encourage enhanced management of subcontractors. For example, the creation of a special subcontractor award fee category would hopefully serve two purposes. First, the amount of fee payable could be based on the prime contractor's use of prescribed procurement practices as well as how equitably a prime contractor shares risks and benefits with his subcontractors. This would help control and mitigate the effects of "overreach." Second, by incentivizing prime contractors to better manage subcontractors, Government requirements for monitoring and surveillance functions with respect to subcontractors would be reduced, resulting in disengagement, reduced administrative costs, and happier prime contractors.

2. DOD level policy organizations should become more involved in the question of subcontract management and at least attempt to determine the degree of involvement, personnel resources required, and organizational approach deemed optional at varying stages of the weapons acquisition process for the effective and efficient monitoring of the prime contractor - subcontractor relationship. Uniform application of DOD-wide policy and guidance regarding subcontract management would greatly assist Program Managers, Contracting Officers and CAO's in determining (1) how best to manage subcontractors, (2) what aspects of the prime contractor - subcontractor relationship are most critical to the fostering of Government interests and requirements, and (3) how to avoid inadvertently shifting risks from prime contractors to the Government when dealing with subcontractors. It may even be feasible and desirable to create a model whereby the methodologies, personnel resources and organizational structure utilized in subcontract management would vary depending on such factors as type of contract, phase of the weapons acquisition process, history and reputation of subcontractors involved, and the past performance of the prime contractor with respect to subcontract management.

3. Renewed emphasis should be placed on the requirement to consent to subcontracts in accordance with established criteria in DAR. It is imperative that subcontracts

requiring consent be thoroughly examined and that those contracts not meeting the specified criteria not be approved pending prime contractor revisions. In addition , to avoid an independent study by the General Accounting Office (GAO), which may be critical with regard to present practices, it is recommended that procuring agencies examine and validate the thoroughness and diligence being exercised by Contracting Officers in the field regarding the consent process.

4. Additional resources should be applied to the CPSR program as well as lowering the current threshold to encompass more, not less, of the major prime contractors who are subsequently charged with the selection and award of subcontracts. Through increased efforts and thoroughness of CPSR's, procurement practices detrimental to subcontractors can be more easily identified and action taken to rectify the situation,thereby mitigating the effects of "overreach" and precluding possible negative effects on subcontractors and the subcontractor base. One added benefit of expanding CPSR's would be a greater potential for Government disengagement from prime contractor operations.

5. Government acquisition officials, working in conjunction with industry officials, should formulate a standard set of terms and conditions which would apply to subcontractors. These terms and conditions would encompass all required Government flow-down provisions, as well as those

terms and conditions necessary for prime contractors to comply with Government obligations originating in the prime contract. While prime contractors would be allowed to seek further terms and conditions from subcontractors, a clear distinction would exist between those terms and conditions necessary due to Government acquisition and those designed to provide prime contractors an extra margin of safety and protection in the performance of their prime contracts. Furthermore, prime contractors could no longer subtley alter Government clauses when passing them along to subcontractors due to nebulous language, meaning, or misinterpretation since the terms and conditions would be explicitly stated, flowed-down verbatum, and would be applicable to all prime contractors who award subcontracts.

6. With respect to subcontractor remedies, it is recommended the Government require prime contractors to utilize a disputes clause in their subcontracts patterned after the NSIA clause included in Appendix B. The use of such a clause would allow prime contractors the opportunity to appeal Government decisions on behalf of subcontractors. However, it also guarantees a subcontractor all rights provided the prime contractor by the Government in the event the prime contractor chooses not to appeal on behalf of an injured subcontractor. Essentially, this clause guarantees subcontractors additional avenues for relief, aside from commercial suits or threats of blackmail, while stopping

short of allowing subcontractors to appeal directly to the Government and circumventing the prime contractor. Additionally, this clause (1) appears to supersede any exculpatory provisions or other clauses which seek to limit prime contractor liability to subcontractors, (2)is in keeping with current DOD policy which allows Contracting Officers to consent to subcontracts containing indirect appeal rights for subcontractors, and (3) provides that performance shall continue pending resolution of the dispute. As the Government has already tacitly agreed to indirect appeals by subcontractors, via the prime contractor, the mandatory inclusion of this clause represents little change for the Government but a large step forward in attempting to equate subcontractor rights and benefits with obligations and requirements currently imposed by the Federal acquisition process. Finally, this clause would only be applicable to those situations where Government acts or omissions directly affect the subcontractor and not in disputes solely betewen the prime contractor and a subcontractor.

7. Ongoing personnel exchange programs between Government and industry, such as those currently implemented within the Air Force, should be expanded to encompass key acquisition personnel within all DOD components as well as solicit additional participation from industry acquisition officials. It is felt such programs tend to reduce the adversarial nature at times prevalent between Government

and industry by creating a better understanding and appreciation of each other's duties, responsibilities, and rights within the Federal acquisition environment. In addition, such programs serve to enhance training and orientation with respect to the Government - prime contractor - subcontractor relations outlined in this effort and appear particularly beneficial to Program Managers, Contracting Officers, and field administrative personnel intimately involved in the Government - prime contractor - subcontractor scenario. It is therefore proposed that DOD, in conjunction with major defense contractors and subcontractors, identify personnel who stand to benefit from the opportunities afforded by additional exchange programs and initiate action to exchange personnel for periods ranging from six to twelve months.

It may also be appropriate at this point to suggest an area deserving of further study. This involves the question and impact of prime contractor "overreach". It is apparent prime contractor "overreach" is attempted and has caused problems in the past as evidenced by subcontractor experiences in the 1973-1974 inflationary period when committed to unrealistically priced option clauses. Furthermore, some degree of Government concern, as to whether prime contractors attempt to fairly and equitably share risk and foster proper procurement percepts with regard to subcontractors, is evidenced by the recent LMI study entitled

"Subcontracting Policy in Major System Acquisition" [25]. Unfortunately, both the sample size of the LMI study as well as this research effort, were limited and therefore definitive conclusions regarding "overreach" are difficult to draw. In addition, while the LMI study concluded "overreach" basically did not occur, or occurred only in isolated instances, this appears counter to the views expressed by the COGP and the thoughts of interviewees during this research. Due largely to this apparent divergence of opinion, and the fact that "overreach" has the potential to weaken and undermine the subcontractor base, a stronger feeling for the degree and impact of "overreach" would better serve Government acquisition personnel in any attempt designed to improve overall weapon system acquisition effectiveness and efficiency.

C. SUMMARY

In summary, while this effort admittedly tackled a broad subject area and was limited by the sample size of personal interviews, the researcher is hopeful that some light has been shed on Government - prime contractor - subcontractor relationships, their impact on the Federal acquistion process, and inherent problems caused by these relationships. Difficulties, such as those posed for the Government in attempting to monitor and control subcontractors while denying them privity of contract, prime contractor frustration and animosity due to over zealous

Government managers, and subcontractor problems of "over-reach" and lack of totally effective recourse in light of Government acts or omissions, all possess the potential for interfering and hampering the primary objectives of the Federal acquisition process. On the other hand, a general concensus was reached by most interviewees that present relationships represent the best possible approach to the effective and efficient acquisition of complex weaponry, which demand the skills and services of a multitude of organizations - both Government and commercial. Therefore, the only viable approach appears to consist of retaining the basic philosophy behind present relationships while striving to achieve those relatively minor modifications and alterations designed to reduce adversity, incorporate the highest degree of fairness, and attempt to make the present system as effective and efficient as is humanly possible.

It is further envisioned that this research effort will benefit its readers by providing insight into present Government - prime contractor - subcontractor relationships and the necessity and rational for their existence. Furthermore, it is hoped such insight will provoke additional thought with regard to inherent problems; resulting in new ideas, innovation, constructive modification, and changes to current practices, procedures and policies. If not, then possibly the mere opportunity to view the issues

from three different perspectives will lead to at least a better understanding of the needs, goals, and objectives of the parties involved which, in and of itself, may lead to a more equitable and efficient acquisition process.

APPENDIX A

Questions for Government Acquisition Officials

1. How would you characterize Government - prime contractor - subcontractor relationships? (i.e., legally, formal, informal, etc.)

2. What do you perceive as the primary objectives of Government - subcontractor relationships?

3. Are current relationships adequate to achieve these objectives? If not, what additional relationships are deemed necessary?

4. Does DOD have an express policy regarding management of subcontractors or does each procuring agency develop its own policies and procedures as to subcontractor management? If no DOD policy, why not?

5. What problems are you currently experiencing regarding subcontractors?

6. Would altering or changing current relationships help alleviate these problems?

7. Do you perceive a better way of managing subcontractors than the methods currently utilized?

8. Do you feel prime contractors are adequately managing subs under their control? Do contracts incentivize primes to manage their subs?

9. Do you feel benefits and risk sharing provisions provided to primes are equitably flowed down to subs?

10. What problems regarding primes do subs bring to the attention of the Government? What advice or remedies can the Government provide? How do we typically respond to subcontractor requests for assistance, etc.?

11. Do you believe the Government has an obligation to protect the subcontractor base through ensuring equitable treatment and fairness between prime and sub? (i.e., is prime contractor "overreach" improper?) If yes, what can the Government do to alleviate this practice?

12. What does the Government want from prime contractors regarding the handling of subcontractors?

Questions for Prime Contractors

1. Do you perceive that direct or indirect relationships exist between Government and subcontractors?

2. What problems do you experience due to these relationships?

3. Do you believe Government - subcontractor relationships are necessary or desirable?

4. Do you feel current Government - subcontractor relationships help or hinder your efforts to effectively manage your subcontractors and deliver the desired goods or services?

5. What changes to existing Government - subcontractor relationships do you believe would benefit the Federal acquisition process?

6. Would you favor a return to more direct Government contractual relations with manufacturers of major weapons system components (i.e., more GFE vice CFE)?

Questions for Subcontractors

1. To what extent is the Government involved in your subcontracting efforts?

2. How has the Government become involved?

3. Given the Government's current role in your subcontracting operations, what do you perceive the role of the Government should be regarding a subcontractor's performance on Givernment contracts?

4. What type of image does the Government portray regarding your operations (i.e., helpful - harmful - annoyance - etc.)? Why?

5. Characterize your relationship with the prime contractor.

6. In negotiating contract terms and conditions what are your bargaining strengths? What are your weaknesses?

7. As a subcontractor are you in a position to ascertain the terms, conditions, benefits and risks accorded the prime contractor by the Government?

8. If so, do you feel the prime fairly and equitably shares these facets of his contract with you? Why or why not?

9. Have you ever experienced disputes/disagreements with primes that could not be settled short of litigation? If so would direct appeal to the contracting officer or ASBCA have been helpful? Why?

10. Do you feel you are familiar with the various rules, regulations, and policies involved in Government contracting so as to understand the ramifications of each as they apply to you as a subcontractor?

11. Does the prime contractor assist you in explaining or interpreting these rules, and regulations?

12. Please describe 3 or 4 problems encountered when performing as a subcontractor under a Government contract not experienced when performing as a subcontractor under a strictly commercial contract.

13. What changes in current Government policy and procedures do you feel would make your job easier and incentivize you to seek additional Government contract work?

14. Do you feel subcontractors are becoming more or less reluctant to seek Government subcontract work due to the unique nature and special requirements of Government subcontracting? Why?

APPENDIX B

Disputes Clause

A. Notwithstanding any provisions herein to the contrary, if a decision on any question of fact or law arising under the Prime Contract be made by the Contracting Officer and such question of fact or law is also connected with or related to this subcontract, said decision, to the extent binding upon the buyer under the Prime Contract, shall in turn be binding upon the buyer and the subcontractor with respect to such question under this subcontract; provided, however, that if the subcontractor disagrees with any such decision made by the Contracting Officer, and if the buyer elects not to appeal such decision, the subcontractor in his own name shall have the right reserved to the buyer under the Prime Contract with the Government to prosecute an appeal within thirty (30) days, to the Secretary of the Department which issued the Prime Contract, or his duly authorized representative. If the buyer elects not to appeal any such decision, the buyer agrees to notify the subcontractor within ten (10) days after receipt of such decision and to assist the subcontractor in its prosecution of any such appeal in every reasonable manner. The buyer, shall, however, be entitled to be represented at any stage of such prosecution and to be

kept currently informed of the progress thereof. If the buyer elects to appeal any such decision of the Contracting Officer, the buyer agrees promptly to furnish the subcontractor with a copy of such appeal. Subject to subdivision B below, any decision upon appeal to the extent binding upon the buyer, shall be binding upon the subcontractor. Pending the making of any decision pursuant to this article, the subcontractor shall proceed diligently with performance.

B. In the event any such appeal is, for any reason, denied or decided adversely to the subcontractor's interests, or in the event the dispute between the buyer and the Government with respect to such a question of fact or law arises after payment with respect to a disputed item has been made by the Government under the Prime Contract, then, if the subcontractor continues to disagree with the disputed conclusion or result, the subcontractor shall have the benefit of any right which the buyer may have to prosecute a suit against the United States. Failure to use such right shall preclude the subcontractor from objecting to the disputed conclusion or result. A final judgment in any such suit shall be conclusive upon the subcontractor and the buyer. The buyer agrees to assist in the prosecution of any such suit in every reasonable manner. All costs of any such suit or of any appeal prosecuted by the subcontractor shall be paid by

subcontractor, without prejudice to any right the subcontractor may otherwise have to recovery or allowance thereof.

C. Any dispute not disposed of in accordance with subdivisions A and B of this Article shall be determined in appropriate legal proceedings.

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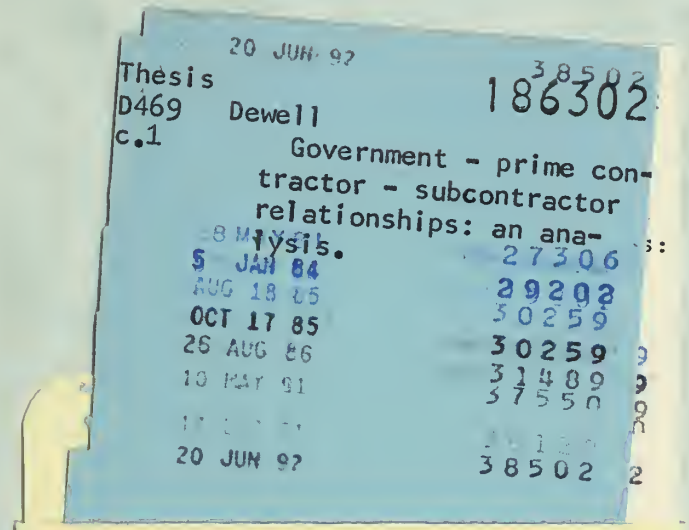

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